

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

Illinois Commerce Commission	:	
On Its Own Motion	:	
-VS-	:	
Commonwealth Edison Company	:	13-0553
	:	
Investigation of tariffs approved in	:	
Docket No. 13-0386.	:	

**PROPOSED ORDER**

**November 13, 2013**



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**I. INTRODUCTION**

On May 22, 2013, the General Assembly enacted Public Act (“P.A.”) 98-0015 which, among other things, amended Section 16-108.5 of the Act, addressing issues related to certain pension assets, retroactive recovery of certain delivery service costs, and reconciliation of the revenue requirement in effect the prior rate year for utilities participating in performance-based formula rates. P.A. 98-0015 provides that it is intended to restate and clarify existing law, to give binding effect to specified legislative intent, and to supersede specified final orders of the Illinois Commerce Commission (“Commission”). Along with other new provisions, P.A. 98-0015 creates Subsection 16-108.5(k)(1), which states that no earlier than five business days after the effective date, each participating utility (as defined in Section 16-108.5(b)) shall file any tariff changes necessary to implement the amendatory language and a revised revenue requirement under the participating utility’s performance-based formula rate. Subsection 16-108.5(k)(1) further required the Commission enter a final order approving such tariff changes and revised revenue requirement within 21 days after the participating utility’s filing.

On May 30, 2013, Commonwealth Edison Company (“ComEd” or “the Company”) filed tariff pages and revised revenue requirements responsive to P.A. 98-0015. On June 5, 2013, the Commission entered an Order in Docket No. 13-0386 finding that ComEd’s proposed tariff changes made on May 30, 2013 were in compliance with the recent legislation and approving the company’s revenue requirement modifications.

On October 2, 2013, the Commission on its own motion, based upon a Staff report which raised questions concerning ComEd’s tariff filing of May 30, 2013, and pursuant to the authority of Section 10-113(a) of the Act to rescind, alter or amend its order in Docket No. 13-0386, initiated a proceeding to determine whether the tariff changes filed by ComEd on May 30, 2013, comply with P.A. 98-0015. The proceeding is

to address the limited specific questions of whether the tariffs filed on May 30, 2013: (1) correctly calculated interest on ComEd's reconciliation balance, (2) correctly calculated the Section 16-108.5(c)(5) return on equity ("ROE") collar, and (3) correctly reflected the appropriate tax treatment in calculating interest on the reconciliation balance in the formula rate tariff as authorized by the Public Utilities Act ("PUA" or the "Act"). Illinois Commerce Commission, ICC Initiating Order Docket No. 13-0553, 2 (October 2, 2013).

An emergency status hearing was held on October 7, 2013, and the parties agreed to a schedule that would allow the Commission to issue an Order prior to November 30, 2013. The People of the State of Illinois, through Attorney General Lisa Madigan ("AG"), the City of Chicago ("City"), the Citizens Utility Board ("CUB") and the Illinois Industrial Energy Consumers ("IIEC"), (collectively "CCI"), were granted leave to intervene.

ComEd presented the testimony of Christine M. Brinkman, Director, Rates & Revenue Policy, and Martin G. Fruehe, Manager, Revenue Policy. Staff presented the testimony of Richard W. Bridal, Accountant, Accounting Department, Financial Analysis Division. The AG presented the testimony of Michael L. Brosch, Principal of Utilitech, Inc., and David J. Effron, Consultant. CCI presented the testimony of Michael P. Gorman, Managing Principal at Brubaker & Associates, Inc.

An evidentiary hearing was held in this matter in Chicago, Illinois on October 24, 2013. On November 1, and November 6, 2013, Initial Briefs ("IB") and Reply Briefs ("RB") respectively, were filed by Staff, ComEd, the AG, and CCI.

## **II. PA 98-0015 COMPLIANCE**

### **A. Do the tariffs filed on May 30, 2013 by ComEd correctly calculate interest on ComEd's reconciliation balance as authorized by the Public Utilities Act?**

#### **ComEd's Position**

It is ComEd's position that its approved formula rate and tariffs filed on May 30, 2013 comply with the requirements of the PUA and correctly calculate interest on its reconciliation balances. ComEd states that the reconciliation adjustment is a regulatory asset or liability that reflects the difference between the revenue requirement used to establish the initial rates for a given rate year (in the current Formula Rate Update ("FRU") proceeding, 2012) and the revenue requirement that recovers the actual costs that were incurred in that calendar year. ComEd asserts that P.A. 98-0015 recognizes that there is a time value of money and that, when there is an under-recovery, ComEd must finance that under-recovery – the difference between its actual costs and the amounts reflected in delivery service charges for a given rate year – until it is included in charges two years later.

ComEd further states that prior to PA 98-0015, that interest rate was set based on a two-year and then on a short-term, debt cost. Commonwealth Edison Co., Docket No. 12-0321 (Order Dec. 19, 2012) at 86. The Company asserts that the aim of the previous interest rates was to enable ComEd to finance the shortfall with only debt and, most recently, with only short-term debt rather than with all the components of ComEd's capital structure, as ComEd financed its other assets. Commonwealth Edison Co., Docket No. 11-0721 (Rehearing Order Oct. 3, 2012) at 33-36. ComEd notes that P.A. 98-0015 rejected that premise, legislatively voided the Commission decisions based on that premise, and directed that the time value of money was to be based on ComEd's whole capital structure. 220 ILCS 5/16-108.5(d)(1) and (k). P.A. 98-0015 directed that the interest rate (i.e., the time value of money) applicable to the delay in receiving (or refunding) the reconciliation adjustment is "to be calculated at a rate equal to" ComEd's weighted average cost of capital ("WACC"). 220 ILCS 5/16-105.8(d)(1); see also 220 ILCS 5/16-108.5(k)(2) and (3). ComEd argues that the law legislatively confirms that ComEd finances these under-collections with its full capital structure, and that any continued suggestions that ComEd either can or actually does something else is not only contrary to the evidence, but inviting an unlawful decision.

ComEd further argues that to recover any financing costs, it is necessary to recognize the added tax costs associated with the equity component of the capital financing that portion of the reconciliation balance. In the Company's view, this includes taxes that will need to be paid as a result of the cash collected for the reconciliation, as any revenue that ComEd receives for the interest on the reconciliation balance is subject to income taxes, and must be recovered in addition to the actual carrying costs related to the reconciliation. ComEd asserts that if the interest rate is not grossed up for this added tax cost, the additional revenues will not be grossed up for the impact of income taxes and the Company will be unable to recover or refund its full carrying costs related to reconciliation. ComEd submits that the straightforward principle that WACC must be adjusted for this tax effect has been recognized for decades in the context of WACC applied to rate base, and its critical importance is no different in this context.

ComEd observes that Staff, the AG, and CCI argue that because the language of Section 16-108.5(d)(1) does not explicitly provide for "earnings or return on the reconciliation balance," but instead specifically addresses the calculation of interest at a prescribed interest rate, ComEd cannot recover income tax costs. In contrast, ComEd asserts that the legislature in Public Act 98-0015 made clear that setting the reconciliation interest at a rate other than a utility's weighted average cost of capital was inconsistent with the original provisions and intent of the Energy Infrastructure Modernization Act ("EIMA"), and emphasized that in specifying interest was to be calculated at a rate equal to WACC it was giving binding effect to the provisions of House Resolution 1157, adopted by the House of Representatives of the 97th General Assembly, and Senate Resolution 821, adopted by the Senate of the 97th General Assembly:

(k) The changes made in subsections (c) and (d) of this Section by this amendatory Act of the 98th General Assembly are

intended to be a restatement and clarification of existing law, and intended to give binding effect to the provisions of House Resolution 1157 adopted by the House of Representatives of the 97th General Assembly and Senate Resolution 821 adopted by the Senate of the 97th General Assembly that are reflected in paragraph (3) of this subsection.

220 ILCS 5/16-108.5(k). Moreover, ComEd notes that the House and Senate Resolutions make absolutely clear that the intent of requiring the reconciliation to be “with interest” was to ensure that the utility and customers are made whole when a reconciliation adjustment is necessary:

WHEREAS, The Energy Infrastructure Modernization Act further provides in subsections (c) and (d) of Section 16-108.5 that those amounts to be credited or charged to customers following the annual reconciliation process under the performance-based formula rate shall be "with interest" so the utility will be made whole for unrecovered amounts that were prudently and reasonably incurred and customers will be made whole for amounts they overpaid, if any; and

WHEREAS, Such interest is intended to be set at the utility's weighted average cost of capital, determined in accordance with the statute, which represents the reasonable cost and means of financing a utility's investments and operating costs, so that the utility and customers are made whole when charges or credits are necessary to reconcile to actual prudent and reasonable investments and costs.

Senate Resolution 821, 97th General Assembly, at 2-3; House Resolution 1157, 97th General Assembly, at 2-3. In light of this legislative evidence, ComEd argues that the proposals to exclude the tax effects of receiving or paying interest on the reconciliation balance in calculating interest equal to a utility's WACC would prevent the utility and customers from being made whole when charges or credits are necessary to reconcile to actual prudent and reasonable investments and costs; as such, these proposals are contrary to EIMA and must be rejected.

ComEd further argues that Staff asks the Commission to read into the statute a prohibition not expressed, or intended, by the General Assembly, and to read out of the law words carefully inserted. *People ex rel. Birkett v. Dockery*, 235 Ill. 2d 73, 81 (2009) (It is a cardinal rule of statutory construction that courts “cannot rewrite a statute, and depart from its plain language, by reading into it exceptions, limitations, or conditions not expressed by the legislature.”); *Solich v. George & Anna Portes Cancer Prevention Ctr. of Chicago, Inc.*, 158 Ill. 2d 76, 83 (1994) (Court not at liberty to depart from the plain language and meaning of the statute by reading into it exceptions, limitations or conditions that the legislature did not express.). ComEd submits that PA 98-0015 specifically directs utilities and the Commission to “calculate” an interest rate applicable to the reconciliation balance that is equivalent to WACC – the weighted average cost of

the utility's capital structure. WACC has a tax cost, which no one can deny. Moreover, ComEd asserts that the General Assembly could have directed utilities to collect interest at the same annual percentage value as is set for its WACC, but it did not. It specifically directed that the utility "calculate" the collected interest rate at a rate which is equivalent to the WACC. According to ComEd, tenets of statutory interpretation require that the language must be given meaning; it cannot be read out of the statute simply because the General Assembly did not spell out that the calculation necessarily includes equity, debt, and taxes. *Hill v. Relyea*, 34 Ill. 2d 552, 555 (1966) ("Absolute criteria whereby every detail necessary in the enforcement of a law is anticipated need not be established by the General Assembly."). ComEd argues that even though the law does not specifically use the word tax, if taxes are ignored the interest rate and the WACC rate will not be equal.

ComEd asserts that because its full capital structure includes both debt and equity components, ComEd must calculate a WACC-based interest to recover its costs – one of these financing costs, is taxes. Staff witness Bridal acknowledges that "the Commission routinely grosses up for income taxes the revenues it authorizes utilities in a rate case to recover from ratepayers ... [and this] allow[s] the utilities to earn the authorized return even after they have paid income taxes owed." ComEd argues that the genesis of these tax costs is plain: the portion of the interest that pays the equity cost component of the WACC will be fully taxable without any related deduction; in contrast, the portion that covers the debt cost component of WACC results in no taxable income. ComEd notes that when assets and/or liabilities are financed through the capital structure as a whole, i.e., at a rate equal to the corresponding WACC for that capital structure, the debt portion of WACC recovers an equal amount of interest expense which is deductible for tax purposes. ComEd asserts that just as in every rate case where the full cost of the capital that finances utility assets must be recovered, the portion attributable to equity results in taxable income that must also be recovered, while the portion attributable to debt does not.

Staff witness Mr. Bridal claims that the gross-up of the WACC for the effect of income taxes is not necessary because the reconciliation amount is the difference between two revenue requirements that were already grossed-up for taxes. ComEd does not dispute that the reconciliation amount is the difference between the two revenue requirements that include a gross-up for taxes. However, ComEd argues that the difference between the two revenue requirements is recorded as additional revenues (or, conversely, a reduction of revenue) to ComEd, which has separate tax impacts. ComEd further clarifies its point, stating that the fact that the principal amount on which interest will be earned reflects taxes related to that principal does not affect the fact that the interest itself will result in still greater tax that is not reflected in the separate gross-up. Mr. Bridal's claim that the revenue requirements already consider taxes completely disregards the tax effects related to the interest. According to ComEd, without the income tax gross-up on the equity portion of the WACC, these additional revenues are not grossed up for the impact of income taxes and ComEd will be unable to recover or refund its full carrying costs related to the reconciliation; such a result conflicts with EIMA's intent to allow ComEd the opportunity to recover its actual costs.



ComEd argues that Staff's view that recognizing EIMA tax costs is inconsistent with Commission practice in rider reconciliations is inapposite, as traditional reconciliation proceedings and the EIMA reconciliation process are not similar. EIMA ratemaking is aimed at providing accurate recovery of rate year revenue requirements. According to ComEd, other "reconciliations" do not involve a reconciliation of a utility's full delivery services revenue requirement or provide for the recovery of interest set at the WACC. A better example in ComEd's case is the cash working capital calculation in ComEd's purchased electricity adjustment rider. There, the cost of capital is grossed up for taxes to account for the full cost of financing the lag (or lead) related to procuring electricity supply for ComEd customers. The rate year reconciliation balance is similar in that it is a lag (or lead) on recovery of ComEd's net revenue requirement for an individual rate year and the full cost of its financing should be recovered (or refunded).

ComEd further notes that the reconciliations Staff points to are not efforts to ensure complete recognition in rates of a utility's full revenue requirement, which EIMA not only intends but mandates. For example, Staff focuses on rider recovery of Water/Sewer Qualified Infrastructure Plant Surcharges ("QIPS") in support of its claim. While QIPS involves recovery of specific additional plant investments ComEd notes that it does not reconcile the revenue requirement and does not provide for full recovery of all reasonable and prudent costs of service (including tax costs). According to ComEd, the only situation that is truly comparable to the instant situation is the application of WACC in the context of establishing a utility's full revenue requirement; it is not contested that WACC is grossed up for income tax effects in that context.

Finally, Staff witness Mr. Bridal points to the Commission's decisions in Docket Nos. 11-0721 and 12-0321. While those dockets did not approve an interest rate that had an equity component and thus had no occasion to consider taxes, Staff makes much of the fact that ComEd did not gross-up the proposed interest rate in those dockets. ComEd does not dispute this fact, but instead points out that the evidence shows that to have been an oversight, not a conscious decision. As ComEd explained, there was no actual reconciliation involved in Docket No. 11-0721, and, therefore, all balances would have been zero. Moreover, ComEd has consistently argued that it could not change the formula in Docket No. 12-0321, as that was an update docket. ComEd asserts that its actual and longstanding position on this issue is quite clear. In previous rate cases stretching back decades, ComEd consistently grossed-up the equity return component of WACC for purposes of recovering the costs of assets financed with its full capital structure.

ComEd argues that the AG simply defies the statute and the resolutions, claiming that they do not "require consideration of the Company's incurred actual incremental financing costs or incremental income taxes arising from specific financing decisions that may be made by the utility." According to ComEd, the AG's argument contradicts the purpose of EIMA as a whole, which is to "reflect actual costs as if they were known when rates charged during each rate year were set" and the specific language of the resolutions, quoted above, that ComEd be made whole. Moreover, ComEd notes that

EIMA directs that the rate formula use the WACC approved by the Commission that reflects the utility's actual capital structure, and argues that because ComEd's capital structure is comprised of both debt and equity financing, using divergent financing, as the AG suggests, would contravene this capital structure.

Similarly, the AG argues that ComEd "will not actually pay income taxes when it collects interest as part of the recovery of the reconciliation balances," and that ComEd is "free to actually finance any changes in the reconciliation balance using any form of capital it desires, including a mix of debt or equity." However, ComEd asserts that it finances the reconciliation balance with its approved capital structure, and that it would be improper to treat all of ComEd's financing costs as if they resulted from debt, because: (1) the reconciliation balance does not represent discrete assets that can be financed, but instead is a mathematical share of the total final reconciliation revenue requirement that is financed by all of the financing elements included in the WACC; and (2) prior findings that ComEd could finance its reconciliation balance with debt alone were rejected by PA 98-0015.

Finally, ComEd argues that Staff, the AG, and CCI ask the Commission to commit reversible error by arguing that the Commission should rely on whether Ameren Illinois Company grosses-up the interest rate to be applied to the reconciliation balance. ComEd notes that it is not a party to that proceeding, and emphasizes that the facts and circumstances of ComEd's Commission-approved formula rate are neither an issue in that proceeding nor within the scope of that proceeding. According to ComEd, the Commission must decide this case "exclusively on the record for decision" in this case. 220 ILCS 5/10-103. ComEd asserts that it should not be denied the right to recover its costs here simply because Ameren's formula appears not to consider these tax impacts.

ComEd states that the legislature made it absolutely clear that the purpose of EIMA was to "[p]rovide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." 220 ILCS 5/16-108.5(c)(1). ComEd states that the statutorily specified "intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates ... with what the revenue requirement determined using a year-end rate base for the applicable calendar year would have been had the actual cost information for the applicable calendar year been available at the filing date." 220 ILCS 5/16-108.5(d)(1). Interest calculated at a utility's WACC without accounting for tax effects in the calculation does not place the utility in the position it would have occupied "had the actual cost information for the applicable calendar year been available at the filing date."

### **Staff's Position**

Staff's position is that the Commission should find that the tariffs filed on May 30, 2013 by ComEd reference revised schedules that would incorrectly reflect the calculation of interest on the reconciliation balance at the grossed up WACC. The revised schedules submitted with the tariffs filed by ComEd on May 30, 2013 are not

correct and must be revised for a number of reasons. First, applying a gross up of the WACC as the rate of interest is contrary to the explicit language set forth in Section 16-108.5(d)(1) of the Act. Second, such a change to the WACC as the interest rate is not necessary, as the reconciliation balance is already the difference between two revenue requirement amounts already grossed-up for the effect of income taxes, and as such, the interest calculated on the reconciliation balance is also already grossed up. Third, such a change to the WACC interest rate is inconsistent with Commission practice with regards to the interest rates applicable in other reconciliation proceedings. Finally, such a gross-up was not set forth in ComEd's previous schedules reflecting the calculation of the amount to be recovered from ratepayers through its formula rates in Docket Nos. 11-0721 and 12-0321. Likewise, the schedules of Ameren Illinois Company ("Ameren" or "AIC") do not reflect a gross-up of the WACC in the calculation of the amount to be recovered through formula rates in Docket No. 13-0301.

1. Gross-up of WACC for Purposes of Calculating Interest on the Formula Rate Reconciliation Balance is Contrary to the Explicit Language of the Act

ComEd's testimony in this proceeding is replete with incorrect statements implying that the Act allows the Company to "earn" on the reconciliation balance. ComEd testimony is also filled with incorrect statements implying that the Act allows the Company a rate of "return" on the reconciliation balance. However, all of these statements suffer from the same infirmity: they misinterpret the explicit language within Section 16-108.5(d)(1) of the Act. Section 16-108.5(d)(1) provides for the calculation of interest on the reconciliation balance, and states, in part:

Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d)(1). The Act does not provide for earnings or return on the reconciliation balance. Rather, the Act explicitly provides for the calculation of interest at a prescribed interest rate. That interest rate is simply the WACC, as defined by the statute. ComEd itself acknowledges this fact, stating "After PA 98-0015 became law, the interest rate used to reflect the carrying costs (i.e., the time value of money) applicable to the delay in receiving (or refunding) the reconciliation adjustment is ComEd's weighted average cost of capital."

When interpreting a statute, the primary objective is to ascertain and give effect to the intent of the legislature. The best indication of what the legislature intended is the statutory language itself. Clear and unambiguous terms are to be given their plain and ordinary meaning and where statutory provisions are clear and unambiguous, the plain language as written must be given effect, without reading into it exceptions, limitations, or conditions the legislature did not express. The Act requires that any reconciliation

over or under collection be refunded or recovered as an additional credit or charge “with interest calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year.” 220 ILCS 5/16-108.5(d)(1). Section 16-108.5(d)(1) of the Act does not provide for adjusting WACC for the purported impact of income taxes. Neither the original language of P.A. 97-0616, the updated language of P.A. 97-0646, nor the updated language of P.A. 98-0015 (which was passed specifically to clarify the law on multiple contested formula rate issues, including the issue of the appropriate reconciliation interest rate) mention any type of adjustment or gross-up to the WACC interest rate for the purported impact of income taxes. Further still, the issue of adjusting the interest rate for the purported impact of income taxes appears to be some new idea of ComEd witness Brinkman, since it was never mentioned in the testimonies of ComEd witnesses Mr. Hemphill or Ms. Houtsma in Docket No. 11-0721, nor ComEd witnesses Mr. Hemphill or Ms. Houtsma in Docket No. 12-0321. Although Company witness Mr. Fruehe claims ComEd has long been aware of the need to recover tax costs due to the gross-up of the equity return component for purposes of calculating an overall return on rate base, he admits ComEd did not include such a gross-up to the WACC interest rate for the purported impact of income taxes until after P.A. 98-0015 became law, calling the omission of the gross-up an “oversight.” Finally, Staff notes that Ameren Illinois Company, which is operating under the same formula rate legislation as ComEd, has not interpreted the PUA to allow the gross up of the WACC for purposes of calculating interest on the reconciliation balance.

2. Gross-up of WACC for Purposes of Calculating Interest on the Formula Rate Reconciliation Balance is Not Necessary From an Accounting Perspective

By definition, the reconciliation balance is the difference between two revenue requirements, and each of those revenue requirements was already grossed-up for income tax that was either expected to be paid or actually paid by the utility. Thus, the reconciliation balance itself is already grossed-up for taxes. This fact is not disputed. Thus, logically, the interest on the reconciliation balance, which is calculated by multiplying the statutorily provided WACC interest rate by the reconciliation balance (which, as stated above is already the difference between two grossed-up amounts), is also already grossed-up for taxes. To gross-up that interest amount for taxes again would give the Company additional compensation for the income taxes ComEd anticipates will be paid on the compensation ComEd will receive for the time value of money.

3. Gross-up of WACC for Purposes of Calculating Interest on the Formula Rate Reconciliation Balance is Not Consistent with Commission Practice

With regards to the Commission’s orders in other reconciliation proceedings, the Commission has not and does not gross-up interest associated with the reconciliation balance. While non-formula rate reconciliations may not involve the reconciliation of the full cost of providing distribution service provided by the formula rate law, non-formula

rate reconciliations nonetheless provide for the reconciliation of at least one component of that distribution service cost. The Water/Sewer QIPS provided for in 83 Ill. Adm. Code Part 656 is the most similar to the formula rates, as it provides for a return on and a return of plant investments in a similar manner as the formula rate revenue requirement. Even so, the Commission has not previously grossed-up the interest associated with the QIPS reconciliation.

The Company attempts to draw a distinction between the formula rate reconciliation balance and the reconciliation balances resulting from other, non-formula rate reconciliations where none exists. Both formula rate and non-formula rate reconciliations result in the same type of reconciliation balance – an under-recovery or an over-recovery of costs associated with distribution services. Further, both formula rate and non-formula rate reconciliations involve the calculation of interest using an interest rate provided for by law or administrative rule. See e.g. 220 ILCS 5/16-108.5(d)(1), 83 Ill. Adm. Code 656.80(i). As such, and contrary to the Company's claims, the reconciliations are fundamentally similar. Consistent with Commission practice with regards to interest rates applicable in other distribution cost reconciliations, the WACC interest rate associated with the formula rate reconciliation should not be grossed-up for income taxes.

4. The Gross-Up in the Interest Rate was Not Reflected in ComEd's Previous Schedules and Ameren Does Not Gross-Up Its WACC

Finally, ComEd filed schedules in Docket Nos. 11-0721 and 12-0321 which did not reflect a gross-up of the interest rate applied to the reconciliation balance. As stated above, and as ComEd witness Brinkman confirms, even though ComEd requested the interest rate applied to the reconciliation balance be the WACC, at no time did ComEd request the Commission to gross-up the WACC for income taxes. It was only after the passage of P.A. 98-15 that ComEd suddenly decided that WACC should include a gross-up. Strangely, ComEd calls this an "oversight." However, ComEd advocated for the WACC to be applied to the reconciliation balance in Docket Nos. 11-0721 and 12-0321 and made no mention of a required gross-up.

Ameren is also a participating utility as is defined by Section 16-108.5 of the Act. Like ComEd, Ameren is undergoing its formula rate update case at this time in Docket No. 13-0301. Unlike ComEd, Ameren did not apply a gross-up to its WACC interest rate. Ms. Brinkman confirmed this fact. Clearly, Ameren does not find it necessary to gross-up the interest rate applied to the reconciliation balance to make itself whole and has correctly interpreted the plain language of P.A. 98-0015.

**AG's Position**

1. ComEd's Additional Gross-Up of the WACC Interest Rate Contradicts the Plain Language of EIMA

The AG presented evidence that the Company's method of grossing up the WACC interest rate applied to the reconciliation balance in fact violates Section 16-108(d). This Section of the Act lays out the terms of the reconciliation process under formula rate regulation, as well as the rate of interest to be applied to any reconciliation under-recovery or over-recovery calculated in the annual formula rate update proceeding. Under that section of the Act, the Commission is required to compare the calculation of the prior calendar year revenue requirement, using recorded input data as reported on the Company's FERC Form 1, to the corresponding previously approved revenue requirement for that same period. 220 ILCS 5/16-108.5(d)(1). The Company is then required to either refund or surcharge this difference in revenue requirement to ratepayers in the annual formula rate update proceeding, plus interest.

Section 16-108.5(d)(1) of the Act, as amended by P.A. 98-0015, now requires that "[a]ny over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year." 220 ILCS 5/16-108.5(d)(1). ComEd, however, calculated interest at a rate equal to its WACC grossed-up for the assumed effect of income taxes, resulting in an increase to WACC from 6.91% to 9.67%.

The AG point out that all of the Staff and Intervenor accountants reviewing ComEd's calculation of the interest applied to the reconciliation balance in this docket, including Staff witness Bridal, AG witness Brosch and IIEC/City/CUB witness Gorman, agreed that ComEd's decision to gross up its WACC for the assumed effect of income taxes is wrong both from an accounting and reasonableness standpoint. As noted above, nothing in Section 16-108.5(d) refers to or permits any gross up of the utility WACC when computing the reconciliation balance interest rate, and the amendments to EIMA authorized by P.A. 98-0015 certainly did not permit this. The language of the statute, as noted above, simply references application of the utility WACC as the interest rate applicable to the reconciliation over- or under-collection, and does not permit the use of the much higher "Total Revenue Effect of Return" now being proposed by ComEd. See 220 ILCS 5/16-108.5(d)(1).

The AG presented detailed argument in their Initial and Reply Briefs demonstrating that ComEd's approach is based on the mistaken premise that "interest calculated at a rate equal to the utility's weighted average cost of capital" is the same as funding based on the mix of debt and equity that funds rate base. Aside from the fact that it is not correct to treat interest as if it has an equity component, if the statute had intended that the over- or under-collection be added to rate base and subject to both an equity and an interest component, the revised statute would have said so. It does not. Therefore, adding an income tax expense factor-up in the manner proposed by ComEd does not reflect the true income tax effect of interest costs, and recovery is inconsistent with fundamental regulatory and accounting principles and overstates the required rate of interest by charging ratepayers for assumed incremental income taxes on equity return amounts that does not represent expenses that ComEd actually incurs. 220

ILCS 5/16-108.5(d)(1). While P.A. 98-0015 changed the rate of interest rate applied to the reconciliation under- or over-collection, it did not alter the application of interest into complex accounting applying assumed but non-applicable income tax impacts to such a “rate”.

Unless adjustments are made to the Company’s calculations in Schedule FR D-1 in Dockets 13-0386 and 13-0318, ratepayers will pay excessive interest for alleged income tax expense effects that the Company is not incurring, as demonstrated in greater detail in the People’s testimony and briefs in this docket.

2. It Is Unnecessary For ComEd To Gross Up The WACC Interest Rate In Order For ComEd To Fully Recover Its Actual Reconciliation Costs.

The AG also note that the Company has not justified its intention to gross up the WACC interest rate in order to fully recover its actual reconciliation costs. As demonstrated in the AG’s testimony and briefs, it is neither necessary nor appropriate to “gross up” the interest rate to recover the costs of equity financing of the reconciliation under-recovery. An interest rate does just that, as it is a percentage value to account for the time value of money. The AG also demonstrated that ComEd’s position represents an attempt to bootstrap the use of the “weighted average cost of capital” in other parts of the formula rate calculation to the reconciliation calculations. The “weighted average cost of capital return on rate base” that is allowed the utility in determining formula revenue requirements is not “interest” but rather reflects a blend of interest cost recovery and an opportunity to earn an authorized level of net income equal to the weighted cost of equity applied to rate base – a point ComEd witness Brinkman did not dispute. In contrast, the reconciliation balance is required to earn only an interest allowance and not a rate base return factored up for the equity-related income tax allowances.

It is also important to note that that ComEd will not actually pay income taxes when it collects “interest” as part of the recovery of the reconciliation balances. As the Company incurs interest expense equal to its weighted average cost of capital when reconciliation balances are being financed, there would be no income tax expense incurred by ComEd because “interest” is income tax deductible. In fact, ComEd acknowledges the income tax deductibility of interest expense. It is not necessary to recognize additional tax costs associated with the equity component of the financing as ComEd asserts. Rather, as pointed out by AG witness Brosch, the specification of an interest rate equal to WACC does not mean that equity and associated income tax costs should be assumed to be incurred. The specification of an interest rate equal to WACC is not the same as specifying that equity costs should be applied to the reconciliation under-collection. ComEd infers that P.A. 98-0015 mistakenly used the word “interest” and that the law actually intended to provide for a composite return allowance that includes both a debt and an equity component, in the form routinely allowed for rate base. The plain language of Section 16-108.5(d)(1) belies that assumption. Therefore,

the AG contend that ComEd wrongly assumes that the Company is allowed recovery of an equity return rather than simply a rate of interest under EIMA.

The AG also noted that the grossing up the interest rate for income taxes has no precedent. Notably, in the Company's own earlier formula rate filings in Docket No. 11-0721 and 12-0321, ComEd did not gross-up its proposed WACC interest rate (in Docket No. 11-0721) nor the approved short-term debt interest rate included within Docket No. 12-0321 formula rate protocols. The first time the new income tax gross-up calculation appeared was in ComEd's Revised Formula Rate Tariff filed on May 30, 2013. Adjusting the interest rate for the purported impact of income taxes was never mentioned in any of the direct testimonies of ComEd witnesses in Docket No. 11-0721 nor in Docket No. 12-0321. In addition, the Company could identify no change in law that has occurred since the 11-0721 and 12-0321 dockets that would justify the gross up methodology ComEd has applied, or where in the Commission's 11-0721 Order such a gross up was authorized. The AG also note the significance of the fact that Ameren did not gross up its calculation of the WACC reconciliation interest rate in its revised formula rate tariffs filed after the passage of P.A. 98-0015.

Unless adjustments are made to the Company's calculations in Schedule FR D-1, ratepayers will pay excessive interest for alleged income tax expense effects that the Company is not incurring and that are not appropriate or intended under P.A. 98-0015.

### **CCI's Position**

CCI contend that ComEd has applied an incorrect interest rate to an inflated reconciliation balance to calculate interest. CCI observe that ComEd "grossed-up" the interest rate equal to its WACC of 6.91% for taxes, increasing the interest applied in reconciliation by 276 basis points, to 9.67%. CCI state that ComEd uses an interest rate higher than the ComEd WACC specified in the Formula Rate Law. Using a rate other than one "equal to" ComEd's WACC in its formula rate calculations violates subsection 16-108.5(d)(1) of the PUA and is in contravention of appropriate accounting practices.

#### **1. The PUA Prohibits a Gross-Up**

CCI maintain that ComEd has overstated its interest rate in direct contravention of the PUA. The PUA specifically provides for interest on the reconciliation balance to be "calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year." 220 ILCS 5/16-108.5(d)(1). CCI aver that the reconciliation interest rate is intended to acknowledge that, because ComEd under-collected in 2012, it should be compensated for the time value of the money on the cash investment in the under-collection.

CCI contend that there is no ambiguity in the statute. The WACC (which in this case is 6.91%) is the interest rate that must be used. CCI argue that ComEd has improperly "grossed up" or "factored-up" the Company's WACC, allegedly for the effect



of income taxes, and used in its reconciliation calculations an interest rate of 9.67%, rather than its actual WACC. ComEd claims that “[t]he gross up accounts for taxes that will need to be paid as a result of the cash collected for the reconciliation...” CCI contend that ComEd is wrong. The Company has not calculated an interest rate equal to its WACC, as required by the Formula Rate, and the tax effect that ComEd claims to offset, does not exist. CCI maintain that the Company’s attempts to collect a higher interest rate than is authorized to carry the cost of the reconciliation balance should be rejected.

CCI note that ComEd admits that the Formula Rate Law does not expressly provide for a gross-up of its WACC interest rate. CCI argues that ComEd treats that absence of its desired calculation as a license to search for its preferred result in speculations about legislative intent, instead of following the explicit directive of the General Assembly in the Formula Rate Law. The proper first step of statutory construction is to “always begin with the language of the statute which is the most reliable indicator of legislative intent.” *People v. Marshall*, 242 Ill. 2d 285, 292 (2011). Here the statutory language is clear; the interest rate is to be equal to the WACC, not in excess of the WACC, and no gross-up is authorized. CCI point out that, where a legislative enactment provides an unambiguous directive, the law requires that the legislature’s words be given effect; searches for deeper -- or more advantageous -- meaning are neither required nor permitted. *Michigan Avenue Nat’l Bank v. County of Cook*, 191 Ill.2d 493, 503-504 (2000); *Ill. Graphics v. Nickum*, 159 Ill.2d 469, 479 (1994).

CCI contend that the Formula Rate Law provides the precise interest rate to be used, and ComEd improperly pursues alternative meanings that drive up its revenue. The words of the statutory provision at issue, however, identify a specific number, for a mathematical calculation and nothing more. CCI argue that there is no need for speculation about how the General Assembly derived the number, the nature of utility reconciliation financing, or tax implications. CCI contend that whether the legislature considered any or all of those topics, it resolved them all in the determination of the appropriate interest rate it expressed in the words of the statute.

CCI’s response to ComEd’s contention that “[t]here is nothing new or novel about WACC gross-ups,” asserts that the Formula Rate Law amendments (a) use an interest rate, not a WACC, and (b) do not require or permit a gross-up of the WACC rate. In addition, CCI point out that the Commission has consistently defined the term “weighted average cost of capital” over a period of almost three decades as:

. . . the sum of the cost of the components of the capital structure, i.e., debt, preferred and preferred stock, and common equity, weighted by their relative proportions in the capital structure.

*Commonwealth Edison Company*, Dkts. 87-0427; 87-0169, 88-0189; 88-0219, (Cons.), Order, Dec. 30, 1988, 1988 Ill. PUC Lexis 11 at 87; see also, *Commonwealth Edison*

*Company*, Dkts. 87-427, 87-0169 (cons.); 88-0189; 88-0219; 88-0253, on Remand, Order, March 8, 1991, 1991 Ill. PUC Lexis 145 at 345. Specifically, CCI note, the Commission's definition of WACC does not include a gross-up, consistent with the absence of a WACC gross-up in the Formula Rate Law, as amended.

CCI argue that, because the statute requires that interest on the appropriate reconciliation balance be "calculated at a rate equal to the utility's weighted average cost of capital," (220 ILCS 5/16-108.5(d)(1)), whether WACC gross-ups "have been used ... for decades" is irrelevant. CCI note that the Commission is not constructing a WACC on its own; it is applying an interest rate explicitly required by law, one that is equal to, not in excess of, ComEd's WACC. In addition, say CCI, the legislature was presumably aware of the Commission's historical practices regarding interest rates (no gross-up). Yet, when it amended the Formula Rate Law to clarify the appropriate reconciliation interest rate, it did not add "grossed-up for the effect of income taxes." Because the statute includes no gross-up provision and the Commission's own definition of WACC also includes no gross-up, CCI contend, there is no basis for ComEd's gross-up of the mandated interest rate, to an interest rate that is not equal to the WACC, but greater than the WACC.

CCI provided an illustrative example to explain the meaning of "grossing-up" (also referred to as "factoring-up"). If an employer offers an employee \$100,000 for one year, assuming that employee is in the 30% tax bracket, the employee will only actually take home \$70,000. In order to take home \$100,000, the company would have to pay the employee \$143,000 (assuming still a 30% tax bracket). The \$143,000 amount is thus the "grossed-up" amount that nullifies the effect of income taxes. However, absent an agreement that the compensation would be grossed-up for income taxes, it is not reasonable for the employee to expect to receive \$100,000 net income. In this case -- assuming, *arguendo*, that income taxes actually would apply -- unless the PUA expressly prescribed such an effect for interest received, CCI contend it would not be reasonable to impose a gross-up on ratepayers.

In ComEd's initial formula rate setting case, and its first reconciliation, the Commission determined that the appropriate interest rate to apply to the reconciliation balance is the Company's short term debt rate. CCI note that in those cases, ComEd did not propose to "gross-up" the interest rate determined and the Commission did not order any such adjustment.

CCI point out that ComEd's own past applications of the Formula Rate Law conform to the interpretation and application proposed by the ratepayer advocates and Staff in this case. In ICC Docket Nos. 11-0721 and 12-0321, ComEd did not advocate for or apply an income tax gross-up to the reconciliation balance. CCI note that the issue of grossing-up the interest rate was never mentioned in the testimonies of Mr. Hemphill or Ms. Houtsma in ICC Docket Nos. 11-0721 or 12-0321, and the Company admits that it did not propose such a gross-up at that time. ComEd claims that was an "oversight." Given the amount of time and energy ComEd expended on the Formula Rate Law, P.A. 98-0015 and in all of the formula rate proceedings under that law, CCI

contend it is simply not credible that ComEd simply forgot to implement such a significant adjustment, which ComEd now claims was there all along. CCI state that it is more likely that ComEd realized, after P.A. 98-0015 was passed, that it could collect an even bigger return if it shoehorned its “gross-up” change into the hurried review of the tariff changes and revised revenue requirement ordered by P.A. 98-0015 in Docket No. 13-0836. Staff and the Commission had neither the time nor resources to discover the unauthorized changes – not all of which are readily apparent – until after the tariffs had been approved. However, note CCI, this investigation is the Commission’s opportunity to right that wrong, and to assure ratepayers that it can remedy such missteps, whether they are simple error or bad faith changes.

Following those earlier cases, CCI observe, the General Assembly enacted P.A. 98-0015 as “a restatement and clarification” of the Formula Rate Law on several contested issues, including the appropriate reconciliation interest rate. The General Assembly clarified that the applicable reconciliation interest rate is “equal to” ComEd’s WACC. Because of the General Assembly amended specific, select provisions of EIMA, CCI argue, if the General Assembly intended for the reconciliation interest rate to be grossed-up for taxes, it would have included that language in P.A. 98-0015. However, CCI note that not one of the three iterations of that provision -- the original language of P.A. 97-616, the updated language of P.A. 97-646, or the updated language of P.A. 98-0015 -- mention any gross-up calculation or any specific reconciliation interest rate other than the WACC.

CCI further note that the other participating utility under the Formula Rate Law, Ameren’s electric distribution service, correctly calculated the interest on its reconciliation balance consistently with all past applications of the reconciliation interest provision and the language of the Formula Rate Law – that is, without any “gross-up” adjustment—using its actual WACC and nothing more. CCI argue that Ameren’s compliance with the consistent interpretation of all parties except ComEd confirms that there is no ambiguity in the statute.

## 2. Tax Deductions Offset the Income Tax So That None Is Owed

CCI aver that there are no income tax impacts that need to be considered in this case. CCI witness Mr. Gorman testified that it is commonly understood in the industry that interest expense is not grossed up for income tax because it is tax deductible. CCI do not contest in this case ComEd’s claimed need to finance the reconciliation balance until it is recovered from ratepayers. However, there is also no dispute that any debt interest ComEd incurs to finance its operations pending reconciliation is deductible for tax purposes, resulting in no taxable income.

CCI point out that ComEd’s argument assumes that the Company actually does finance the reconciliation balance with a combination of debt and equity. In reality, the Company is free to finance any changes in the reconciliation balance using any form of capital it desires – a mix of debt and equity, or solely debt or equity. Though the statute

requires that ComEd receive interest from ratepayers in an amount equal to WACC, CCI aver it includes no requirements on the actual rate at which ComEd must finance its investment in the reconciliation balance. The actual financing decisions are made by the utility.

CCI demonstrate that the interest ComEd receives on the reconciliation balance compensates the Company for the lost time value of money as a result of under-collecting in 2012. CCI explain that any interest expense incurred by a business is fully deductible in determining taxable income and therefore has no tax impact. Even assuming ComEd incurs interest at the same rate (WACC) that it recovers from ratepayers, CCI state that the taxable income resulting from incurring and then recovering such interest would be zero. In other words, the tax deduction ComEd received from incurring interest expense to cover the amount of under-collection should fully offset the revenues received from ratepayers to recover interest on the reconciliation balance.

CCI point out that ComEd's current position contradicts its previous arguments about this issue. Only one year ago, ComEd argued that the interest rate on the reconciliation balance must be set at a rate equal to its WACC because the WACC is what ComEd actually pays the capital markets for the use of money when it is forced to carry the cost of the reconciliation balance due to an underestimate of costs. 11-0721, Order on Rehearing at 26 (Oct. 3, 2012). ComEd argued

only an interest rate equal to its weighted average cost of capital ("WACC") will account for the time value of money... the WACC is what it actually pays the capital markets for the use of money when it is forced to carry the cost of the reconciliation balance due to an underestimate of its costs. The WACC also reflects the value ComEd receives from the use of the money when it has overestimated its costs.

*Id.* CCI contend the passage of PA 98-15 gave ComEd exactly what it stated it wanted—an interest rate equal to the Company's WACC. But now, suddenly, the WACC alone will leave ComEd "unable to recover or refund its full carrying costs related to reconciliation." CCI argue that despite ComEd's success in getting PA 98-15 passed, which changed the interest rate applied to the reconciliation balance to equal its WACC, ComEd now argues that interest at the WACC rate alone is not really what the Formula Rate Law intended to implement. CCI contend that the absence of a gross-up in ComEd's prior proposals hardly seems an "oversight" -- as ComEd now asserts. Also absent from ComEd's argument a year ago is the recent effort to transform an interest rate into a rate of return.

CCI state that ComEd does not provide any reasonable explanation why the Commission should allow it an interest rate greater than the statutorily-mandated (and previously ComEd-requested) WACC. More important, ComEd identifies no authority for the Commission to use any reconciliation interest rate that is not "equal to the utility's

weighted average cost of capital.” 220 ILCS 5/16-108.5(k)(3). CCI note that the PUA explicitly states that the WACC is the interest rate to be used, and ComEd’s proposal is plainly inconsistent with that language. Additionally, a gross-up is an inappropriate deviation from the consistent regulatory accounting the Commission uses in its reconciliation proceedings.

### **Commission Analysis and Conclusions**

This Section of the PUA specifically provides for interest on the reconciliation balance to be “calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year.” 220 ILCS 5/16-108.5(d)(1) This Section of the Act does not provide for adjusting WACC for the purported impact of income taxes. The Commission is not constructing a WACC on its own; it is applying an interest rate explicitly required by law, one that is equal to, not in excess of, ComEd’s WACC. No “gross-up” was provided for in the Act. ComEd’s proposal would require the Commission to apply an interest rate greater than WACC. The fact that the legislature, in P.A. 98-0015, specified an interest rate, not a return and set WACC as the interest rate to be applied to the reconciliation balance, without any mention of a “gross-up” for the effect of income taxes is determinative. The Commission notes that, in the Rehearing phase of ICC Docket 11-0721, ComEd argued that the interest rate on the reconciliation balance must be set at a rate equal to its WACC because the WACC is what ComEd actually pays the capital markets for the use of money when it is forced to carry the cost of the reconciliation balance due to an underestimate of costs. It does not seem that this recovery is authorized under the amended statute. Therefore, the Commission declines to adopt the Company’s interpretation of the statute to gross up the interest rate.

#### **B. Do the tariffs filed on May 30, 2013 by ComEd correctly calculate the Section 16-108.5(c)(5) return on equity ("ROE") collar as authorized by the Public Utilities Act?**

### **ComEd’s Position**

It is ComEd’s position that its formula rate and tariffs filed on May 30, 2013, comply with the requirements of Section 16-108.5(c)(5) of the PUA and correctly calculate the ROE collar. ComEd argues that the approved rate formula uses a year-end capital structure based on ComEd’s FERC Form 1 balances for all purposes, including calculating the ROE Collar. ComEd further states that the approved rate formula also uses rate base components, including plant in service, uniformly based on those year-end balances. This approach is internally consistent, financially sensible, and produces meaningful results. ComEd submits that the AG’s and CCI’s argument that an average rate base should be utilized for purposes of making the ROE Collar calculation is contrary to law. Moreover, ComEd notes that in its briefs, Staff did not support the use of an average rate base for the calculation of the ROE collar.

In support of its position, ComEd submits that the use of a year-end rate base in calculating the applicable revenue requirements and reconciliation is required by P.A. 98-0015, including the following codified as Section 16-108.5(d)(1):

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year.”

220 ILCS 5/16-108.5(d)(1). ComEd notes that P.A. 98-0015 superseded prior rulings on use of an average rate base, and argues that P.A. 98-0015 clearly established that the year-end rate base is the only permissible rate base to use when calculating the applicable revenue requirements and reconciliation.

Although the words “year-end” do not literally appear within the language of Section 16-108.5(c)(5) establishing an ROE Collar calculation, ComEd argues that they are incorporated by reference through the requirement that the earned rate of return on common equity be calculated “consistent with this Section” – which refers to Section 16-108.5 of the Act. 220 ILCS 5/16-108.5(c)(5). Section 16-108.5(c)(5) provides, in part, as follows:

If the participating utility's earned rate of return on common equity related to the provision of delivery services for the prior rate year (calculated using costs and capital structure approved by the Commission as provided in subparagraph (2) of this subsection (c), consistent with this Section, in accordance with Commission rules and orders ...) is more than 50 basis points less than the return on common equity calculated pursuant to paragraph (3) of this subsection (c) ... then the participating utility shall apply a charge through the performance-based formula rate that reflects an amount equal to the value of that portion of the earned rate of return on common equity that is more than 50 basis points less than the rate of return on common equity calculated pursuant to paragraph (3) of this subsection (c) ... for the prior rate year, adjusted for taxes.

220 ILCS 5/16-108.5(c)(5).

Section 16-108.5(c)(2) requires that the formula rate reflect a year-end capital structure:

(2) Reflect the utility's actual year-end capital structure for the applicable calendar year, excluding goodwill, subject to a determination of prudence and reasonableness consistent with Commission practice and law

*Id.* at (c)(2). Section 16-108.5(d)(1) provides that the reconciliation and reconciliation revenue requirement shall be determined using a year-end rate base:

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (*determined using a year-end rate base*) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year.

*Id.* at (d)(1). ComEd argues that this section of the PUA further specifies that the intent of the reconciliation is to reconcile the revenue requirement initially included in rates with the actual revenue requirement determined using a year-end rate base:

Notwithstanding anything that may be to the contrary, *the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates* for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, *with what the revenue requirement determined using a year-end rate base for the applicable calendar year would have been* had the actual cost information for the applicable calendar year been available at the filing date.

*Id.*

According to ComEd, the law is clear: the ROE collar calculation would not be consistent with the requirements of Section 16-108.5 if it were based on anything other than a year-end rate base. ComEd submits that, in light of this solid statutory basis for use of a year-end rate base for the ROE collar, AG witness Mr. Effron's argument that EIMA does not specifically *reject* use of an average rate base is unconvincing at best.

ComEd observes that the AG continues to argue that an average rate base should be utilized for purposes of making the ROE collar calculation, a position that is similarly supported by CCI. In response, ComEd notes that even aside from the statutory provisions supporting use of the year end rate base, the AG's advocacy of an "average rate base" when calculating the earned ROE for the purpose of the ROE Collar calculation would create a mismatch when calculating ComEd's earned ROE. In contrast, according to ComEd, there is no average rate base in the approved formula, in ComEd's FERC Form 1, or in the statute, and the average rate base does not equate to the year-end rate base for any year. ComEd submits that the AG's proposal would have *the financial effect* of replacing the year-end rate base in both the collar calculation and the reconciliation revenue requirement, and that the use of an average rate base would result in an artificially inflated earned ROE by reducing the amount of rate base financed by both debt and equity resulting in both a higher net income due to a reduction in long-term interest expense and higher ROE given the higher income (numerator) and the lesser amount of equity (denominator), which would create an artificial impression that ComEd's earnings were further outside the ROE Collar band than they actually were. Alternatively, if ComEd's average rate base is higher than its

year-end rate base, the ROE is artificially deflated when compared to the value calculated utilizing a year-end rate base.

AG witness Mr. Effron claims that his proposal would not modify the rate base used to establish the initial revenue requirement or the rate base used in the reconciliation. However, according to ComEd, this disregards the ultimate effect that this change would have. According to ComEd witness Ms. Brinkman, “it makes no sense to base an earnings test like the ROE Collar on a method of measuring rate base at odds with the method used to set the initial revenue requirement, the actual-cost reconciliation revenue requirement, and ultimately the charges applicable to customers.” ComEd emphasizes that the real and practical effect of Mr. Effron’s proposal would achieve the same result clearly rejected by P.A. 98-0015 – to replace the year-end rate base in both the collar calculation and the reconciliation revenue requirement.

ComEd observes that AG witness Mr. Effron claims that PA 98-0015 nowhere expressly rejects the use of an average rate base in the ROE collar calculation, and uses this as a justification for his reliance on the use of the average rate base. In contrast, ComEd submits the House and Senate Resolutions incorporated in part by reference in P.A. 98-0015, which addressed the legislature’s intent with respect to certain language in EIMA – including the application, scope, and authority related to the legislature’s provision for the use of a final year-end rate base under EIMA. ComEd asserts that the House and Senate Resolutions make clear that nothing other than a year-end rate base may be used with respect to EIMA:

WHEREAS, The Energy Infrastructure Modernization Act also provides that the final *year-end* cost data filed in FERC Form 1 should generally be used to determine rates; and

WHEREAS, No statutory authority was given to the Illinois Commerce Commission to set rate base and capital structure using average numbers that do not represent final *year-end* values reflected in the FERC Form 1, and the Illinois Commerce Commission's use of such average is contrary to the statute;

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RESOLVED ... that we express serious concerns that the Illinois Commerce Commission Order, entered on May 29, 2012 in Commission Docket No. 11-0721, fails to reflect the statutory directives and the intent of the Illinois General Assembly by: ... (3) determining rate base and capital structure using an average, rather than the *year-end* amounts as reflected in FERC Form 1;

Senate Resolution 821, 97<sup>th</sup> General Assembly, at 3, 4-5; House Resolution 1157, 97<sup>th</sup> General Assembly, at 3, 4-5 (emphasis added); 220 ILCS 5/16-108.5(k).



ComEd concludes that the AG's and CCI's argument that there is no statutory requirement to use year-end rate base in performing the ROE collar calculation under EIMA is contrary to law and must be rejected in view of the clear statutory language and the specific legislative pronouncements to the contrary. ComEd further finds the AG's and CCI's proposal unreasonable in that it suggests the legislature required use of a year-end rate base methodology to calculate the revenue requirements to be included in rates and utilized for reconciliations, only to undo and undermine that requirement by requiring an ROE collar adjustment each year that would be based on an average rather than a final year-end rate base. ComEd submits that the AG's argument on this issue is obviously contrary to law, and it must be rejected.

### **Staff's Position**

Staff's position is that the tariffs filed on May 30, 2013 by ComEd reference revised schedules that would correctly calculate the return on equity ("ROE") collar as authorized by the Section 16-108.5(c)(5) of the Act. Staff cannot support the proposal made by Mr. Effron to use average rate base for purposes of the ROE collar calculation. The proposal, regardless of its merits, should be rejected because, although the Act does not specifically prescribe use of either average or year-end rate base for purposes of the ROE calculation, year-end rate base is the only rate base specifically prescribed elsewhere in Section 16-108.5 of the Act.

In describing the ROE collar calculation, Section 16-108.5(c)(5) of the Act states, in part:

If the participating utility's earned rate of return on common equity ... (calculated using costs and capital structure approved by the Commission as provided in subparagraph (2) of this subsection (c), consistent with this Section, in accordance with Commission rules and orders, including, but not limited to, adjustments for goodwill, and after any Commission-ordered disallowances and taxes) [...].

220 ILCS 5/16-108.5(c)(5) (emphasis added).

After revision by Public Act 98-0015, Section 16-108.5(c)(2) of the Act states in part that the performance-based formula rate shall:

reflect the utility's actual year-end capital structure for the applicable calendar year, excluding goodwill, subject to a determination of prudence and reasonableness consistent with Commission practice and law.

220 ILCS 5/16-108.5(c)(2) (emphasis added).

Following revision by Public Act 98-0015, Section 16-108.5(d)(1) of the Act also requires use of a year-end rate base for *reconciliation purposes*, concluding subparagraph (1) stating in part:

Notwithstanding anything that may be to the contrary, the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement determined using a year-end rate base for the applicable calendar year would have been had the actual cost information for the applicable calendar year been available at the filing date.

220 ILCS 5/16-108.5(d)(1) (emphasis added).

While the Act does not specifically prescribe use of either average or year-end rate base for purposes of the ROE collar calculation, it is well established in Illinois that related statutes should be construed in a harmonious manner and in a manner that advances, not defeats, the legislative intent. Year-end rate base is the only rate base specifically prescribed elsewhere in Section 16-108.5 of the Act. 220 ILCS 5/16-108.5.

The Act is clear that year-end capital structure must be used for purposes of the ROE calculation. 220 ILCS 5/16-108.5(c)(5). However, because the Act does not specifically prescribe use of either average or year-end rate base for purposes of the ROE calculation and because year-end rate base is the only rate base specifically prescribed elsewhere in Section 16-108.5 of the Act, Staff concludes that use of year-end rate base to calculate the ROE collar is most consistent with the Act.

### **AG's Position**

The AG contend that ComEd's proposed calculation of the collar adjustment underestimates the Company's return on equity, resulting in a smaller collar adjustment, thus increasing the net revenue requirement, to the benefit of ComEd shareholders and the detriment of ratepayers. The AG therefore, urge the Commission to correct this inequity now, in order to ensure that rates for the next several years of formula ratemaking are set correctly.

1. P.A. 98-0015 did not authorize use of an end of year rate base in the ROE collar calculation.

The Company proposes to use the rate base as of the end of the 2012 reconciliation year for the purpose of calculating the delivery service common equity balance and fixed cost capital balances. That is, the Company uses the *actual* rate base as of December 31, 2012, based on the 2012 FERC Form 1 to quantify the balance of common equity used in the ROE computation and the interest and preferred dividends used in the quantification of the net income available for common equity. As noted by AG witness Effron, rather than the end-of-year rate base, the average rate base for the year should be used in the calculation of the earned ROE for the purpose of the collar calculation.

The AG note that the use of year-end rate base for calculating the ROE collar is without precedent. In Commonwealth Edison dockets 11-0721 and 12-0321, and Ameren Dockets 12-0001 and 12-0293, the Commission determined that in order to reflect the actual costs incurred by the utility in the reconciliation year, the formula rate template should use the average rate base for calculating the reconciliation year rev req. See, e.g., Docket 12-0001, Order of September 19, 2012 at 174-175; Docket No. 12-0321, Order of December 19, 2012 at 4.

The AG also note that use of year-end rate base results in inconsistency. As AG witness David Effron testified in this docket, “[t]he net income used in the ROE calculation is the income earned over the course of the year, not the annualized net income being earned at the end of the year. To be consistent, the common equity balance used in the denominator of the ROE calculation should be the average balance of common equity over the course of the year.” AG Ex. 2.0R at 4.

Importantly, the changes to P.A. 98-0015, as detailed in the AG’s Initial Brief and Reply Brief, do *not* address the ROE collar computation. Rather, the ROE collar computation is described in a different Subsection: 16-108.5(c)(5). Unlike Subsection 16-108.5(d) which addresses the calculation and treatment of the utility’s expenses and revenue requirement, Subsection 16-108.5(c)(5) addresses the Company’s actual profitability. When Section 16-108.5(d) was amended this past spring to specify that the reconciliation revenue requirement should be calculated using an end-of-year rate base, the section describing the ROE collar, Section 16-108.5(c)(5), was not changed to specify the use of an end of year rate base calculation of the collar adjustment. Under statutory interpretation rules, when certain things are enumerated in a statute, that enumeration implies the exclusion of all other things even if there are no negative words of prohibition. See *People ex rel. Daley v. Grady*, 548 N.E.2d 764, 766 (Ill. Ct. App. 1989). When an act lists things to which it refers, the court may infer that any omissions were intended as exclusions. *Bank of Waukegan v. Kischer*, 246 Ill. App. 3d 616, 620 (1993).

2. Using A Year-End Rate Base In the Calculation of the Utility’s Earned ROE Overstates the Actual Capital Supplied by Equity Investors to Support the Company’s Rate Base Over the Course of the Year.

The AG contend that ComEd’s decision to extend the very specific changes authorized by the General Assembly in P.A. 98-0015 to the calculation of the ROE collar results in unjust and unreasonable rates. In order to produce a dollar balance that correctly represents the actual capital supplied by equity investors to support the Company’s rate base over the course of the year for which the ROE is being calculated, the common equity ratio must be applied to an average rate base. To be consistent, the common equity balance used in the denominator of the ROE calculation should be the average balance of common equity over the course of the year. The AG’s recommendation results in an accurate statement of earned ROE and consistency in calculation.

The AG point out in detail in their Initial and Reply Briefs that ComEd's own Exhibit 1.04 demonstrates why the use of a year-end rate base in the ROE collar calculation understates the actual earned ROE when the year-end rate base is greater than the average rate base. In order to avoid such understatement of the earned ROE, the average rate base should be used in the collar calculation.

The purpose of calculating the ROE collar using average rate base is to avoid treating the debt and equity as of the end of the year as if it had been in existence for the whole year, as ComEd's calculation does. Using the year-end capital structure simply means that the common equity ratio will be applied to the average rate base rather than to the year-end rate base. The AG's approach maintains the year-end relationship between debt and equity, but applies it to the growth of investment over the course of the year. In short, the use of an average rate base in the ROE collar calculation simply ensures that the calculation of the utility's returns should reflect the actual capital invested in the enterprise over the period for which the return is calculated.

AG witness Effron provided a detailed discussion of how the ROE collar computation should be modified to reflect the Company's actual capital supplied by equity investors to support the Company's rate base over the course of the year for which the ROE is being calculated. Incorporating Mr. Effron's well-supported use of an average rate base in the ROE collar calculation results in a 2012 ROE of 9.75%. This leads to an ROE collar adjustment on Schedule FR A-1 of \$(25,308,000) as compared to the Company's ROE collar adjustment of \$(6,395,000), with the amounts in parentheses signifying earnings in excess of the collar's range. Thus, this adjustment results in a reduction to the Net Revenue Requirement on Line 36 of Schedule FR A-1 in Docket No. 13-0318 of \$18,913,000, exclusive of any interest. This calculation is reflected in Mr. Effron's Ex. 2.1, pages 1 and 2 (DJE-3), attached as Appendix B.

The AG urge the Commission to adopt this adjustment in order to ensure that the Company's reported earnings for purpose of the collar calculation are not understated, thereby depriving ratepayers of the requisite collar reduction to the Company's 2014 net revenue requirement.

### **CCI's Position**

CCI contend that ComEd's ROE calculation should be based on average rate base in the ROE collar calculation, as the Commission has previously determined. CCI note that the ROE collar calculation in Section 16-108.5(c)(5) provides that, if the actual earned ROE for a reconciliation year revenue requirement is more than 50 basis points higher than the ROE allowed under the statutory formula rate for that year (after reflecting penalties imposed for failure to meet metrics and performance goals once those goals and metrics apply), then an adjustment will be made to the net revenue requirement to credit customers for the excess. Similarly, if the actual ROE earned by ComEd, after reflecting prudence and reasonableness disallowances, falls more than 50

basis points below the allowed ROE (after reflecting penalties imposed for failure to meet metrics and performance goals once those goals and metrics apply), an adjustment in the amount of the shortfall will be made to the net revenue requirement in the reconciliation proceeding to recover the deficiency.

CCI point out that, prior to the formula rate protocol changes pursuant to P.A. 98-0015, the Commission had determined that identification and recovery of actual costs, with the collar applied on that basis, required a participating utility to use average rate base for the purpose of calculating the reconciliation adjustment. The ROE collar schedules used to assess ComEd's earnings used average rate base for the purpose of calculating the collar adjustment. While the revised Section 16-108.5(c)(2) explicitly addressed the utility capital structure calculation, it was silent on the calculation of the ROE collar adjustment.

However, CCI note, when ComEd changed the reconciliation rate base from average to year-end to comply with P.A. 98-0015, it also changed Schedule FR A-3 relative to the calculation of the distinct ROE collar calculation described in Section 16-108.5(c)(5), to reflect ComEd's assumption that it also should be calculated using year-end rate base. This modification substantially reduces the ROE collar adjustment for 2012, thereby reducing the amount by which rates would decrease because of ComEd's earnings exceeding the 50 basis point collar. CCI contend this change was not authorized by P.A. 98-0015. Furthermore, say CCI, this change represents an unauthorized, unilateral reversal of the Commission's prior determinations requiring the use of average rate base for the purpose of measuring the ROE collar adjustment. CCI aver that if ComEd's changes to the calculation of the ROE collar from average rate base to year-end rate base are left unaltered, ComEd would collect revenues that do not reflect the Company's actual costs, resulting in rates that are not just and reasonable under Section 9-101 and 16-108.5(c) of the PUA.

CCI contend that the average rate base for the year, rather than year-end, should be used in the calculation of the earned ROE for the purpose of the collar calculation. CCI rely in part on Mr. Effron's reasoning that applying the common equity ratio to the average rate base will produce a dollar balance that correctly represents the actual capital supplied by equity investors to support the Company's rate base over the course of the year for which the ROE is being calculated. CCI aver that the net income used in the ROE calculation is the income earned over the course of the year, not the annualized net income being earned at the end of the year. To be consistent, say CCI, the common equity balance used in the denominator of the ROE calculation should be the balance of common equity over the course of the year, computed as the average balance over that period. CCI maintain that in times when the common equity balance is growing, using the end of period balance of common equity will understate the actual ROE earned on common equity provided by investors over the course of the year, and in times when the common equity balance is decreasing, using the end of period balance of common equity will overstate the actual ROE earned on common equity provided by investors over the course of a year.

The revisions to the formula rate law effectuated in May 2013 by P.A. 98-0015 amended Section 16-108.5(c)(2) to require use of the year-end capital structure in the revenue requirement formula. CCI contend that ComEd goes too far in boldly claiming that the year-end rate base is the rate base that must be used when calculating the ratio of ComEd's earnings over the year to its prudent and reasonable investment used to provide delivery services over that period. CCI aver that, when the General Assembly enacted P.A. 98-0015, it had the opportunity to "fix" the distinct assessment of actual revenues collected from ratepayers and dollars of dedicated investment against the permissible ROE range. It could have, but did not, specify how to measure the ROE for purposes of calculating the collar adjustment, note CCI. CCI aver that if the General Assembly had intended that to be the case, it could have amended that language also – clearly the General Assembly understood the significance of the term "year-end". It is significant that the legislature chose not to use that term to describe the ROE collar assessment of actual collections and earnings levels, say CCI.

However, say CCI, the amendments did not require use of a year-end rate base in the ROE collar calculation. In fact, note CCI, the collar calculation is separate from the various determinations involving the Company's revenue requirements (projected or actual) for a given year. CCI contend that unlike those revenue requirement processes, the ROE collar process assesses the effect of ComEd's collected revenues, not its costs. CCI aver that the ROE collar check is a determination of whether the rates in effect for a given year produced a return on equity outside a defined range.

CCI note that ComEd's imputes language into the statute that does not exist by implying a statutory mandate to use year-end rate base to measure its earnings for purposes of the ROE collar. As clear and unambiguous as the statute is in certain places, e.g. with requiring the interest on the reconciliation balance to be calculated at a rate equal to the WACC (though, oddly, ComEd sees ambiguity there, where there is none), CCI note that it is silent with regard to the rate base measurement to use in the calculation of the ROE collar adjustment. CCI aver that the silence of EIMA is clear in ComEd's lengthy and convoluted statutory construction and legislative history arguments attempting to convince the reader that the General Assembly *meant* to say "year-end" in Section 108.5(c)(5), though it did not.

CCI note that Mr. Effron is not making a recommendation regarding the calculation of the reconciliation difference between ComEd's projected and actual revenue requirements, and thus his adjustment in no way has "the effect of replacing the year-end rate base ... values utilized in the reconciliation calculation with an average rate base" as Ms. Brinkman erroneously claims. Nor, CCI aver, does AG witness Effron challenge the ratemaking principle that utilities "must have the opportunity to earn returns commensurate with capital market demands." CCI state that Mr. Effron's proposal does not challenge this notion, but rather ensures that only the actual capital invested in the enterprise over the period for which the return is calculated is reflected.

In response to ComEd's claims that Mr. Effron's approach would produce a "mismatch" when calculating ComEd's earned ROE, and that this approach would artificially inflate the earned ROE, CCI note that AG witness Effron demonstrated that a mismatch only occurs under ComEd's methodology. Using year-end rate base tends to artificially *deflate* the calculated earned ROE, aver CCI. CCI state that Mr. Effron demonstrated that Ms. Brinkman's reasoning is wholly circular: the only reason that the earned ROE is "artificially inflated" in her example is that it is compared to the ROE calculated using a year-end rate base. CCI contend that the calculation of the participating utility's returns for purposes of the ROE collar calculation should reflect the actual capital invested in the enterprise over the period for which the return is calculated. The best measurement of ComEd's actual costs is its average rate base, say CCI, because it best represents the capital deployed to earn income over the course of the year. This is precisely what the Commission previously concluded – prior to the 2013 amendments to EIMA – regarding the calculation of ComEd's revenue requirement and the ROE collar. See, e.g., Docket No. 12-0321, Order of December 19, 2012 at 4, Schedule FR A-3. CCI maintain that this determination should not be altered because the amendments to EIMA did not change Section 16-108.5(c)(5), and thus the Commission's previous fact and statute based determinations regarding the ROE collar calculation remain intact.

CCI point out that ComEd did not present any evidence refuting Mr. Effron's conclusion that "[w]hen rate base increases over the course of the year, the use of a year-end rate base tends to artificially deflate the calculated earned ROE relative to the ROE actually earned." AG Ex. 4.0 at 8:170-173. ComEd attempted to undermine the use of average rate base in calculating the ROE collar adjustment by showing a similarity between the dollar value of the adjustment to that from use of average rate base for the reconciliation balance. CCI aver that this results-driven illustration simply attempts to justify ComEd's preferred calculation by comparing it -- with no statutory basis -- to the measurement of the reconciliation balance under EIMA. CCI state that the very specific and limited P.A. 98-0015 revisions to EIMA do not require use of year-end rate base for purposes of the ROE collar adjustment, and no such change is necessary to effectuate the objectives of EIMA.

CCI further note that ComEd does not argue that the year-end rate base is an accurate measure of the investment it dedicated to providing service, only that (in its view) the specification of a year-end rate base for purposes of determining the reconciliation balance is required by P.A. 98-0015. The latter distinct process is not defined by a provision amended by P.A. 98-0015. CCI state that there is no dispute that the reconciliation process addresses only revenue requirements, with no consideration of the actual amounts ComEd collects. That function is left to the ROE collar calculations. The ROE collar has a different focus than the calculation of the reconciliation balance. CCI maintain that, regardless of the size or accuracy of ComEd's statutorily computed revenue requirement, the ROE collar looks only at the ratio of ComEd's actual earnings to its equity investment – a calculation that does not implicate the year-end rate base specification of P.A. 98-0015.

CCI argue that ComEd cannot use the Commission's approval of ComEd's calculations in its Docket No. 13-0386 filing as a defense to reversing the Commission's previous findings regarding the calculation of the ROE collar. CCI point out that the Commission initiated this docket with the express intent of reviewing certain aspects of the tariff filing made in that docket and to determine whether ComEd's May 30, 2013 tariff filing is in compliance with the law. CCI note that the Commission's Initiating Order notes the Commission's authority to "rescind, alter or amend its order in Docket No. 13-0386," pursuant to Section 10-113(a) of the PUA.

With respect to Staff's position, CCI argue that, in accepting ComEd's approach using year-end rate base in the ROE collar adjustment, Staff's main argument is simply that year-end is the only one specifically mentioned in other parts of the statute. CCI aver that this reasoning is an insufficient basis on which to reverse a previous Commission determination to use average rate base for purposes of this calculation. The Commission is capable and willing (having already done so) to determine the rate base that is consistent with its Article IX duties and standards to produce just and reasonable rates that recover ComEd's actual costs. The collar calculation is the only assessment of whether the amount ComEd collected equaled (within the statutorily allowed variance) its actual costs.

CCI conclude that if ComEd's changes to the calculation of the ROE collar from average rate base to year-end rate base are left unaltered, ComEd will collect revenues that do not reflect the Company's actual costs, resulting in rates that are not just and reasonable under Sections 9-101 and 16-108.5(c) of the PUA. Because the amendments to EIMA did not require use of year-end rate base for purposes of the ROE collar calculation, and because nothing has altered prior Commission practice regarding use of average rate base in calculating the ROE collar, CCI recommend that the Commission adopt the recommendation of AG witness Effron to revise ComEd schedule FR A-1 to comport with the law and the evidence in this proceeding by using average rate base in the calculation of the ROE collar adjustment.

### **Commission Analysis and Conclusions**

The Act is clear that year-end capital structure must be used for purposes of the ROE calculation. 220 ILCS 5/16-108.5(c)(5). However, because the Act does not specifically prescribe use of either average or year-end rate base for purposes of the ROE calculation and because year-end rate base is the only rate base specifically prescribed elsewhere in Section 16-108.5 of the Act, it can be concluded that use of year-end rate base to calculate the ROE collar is most consistent with the Act. As Staff noted, a year-end rate base "is the only rate base specifically prescribed anywhere in Section 16-108.5 of the Act." Section 16-108.5(c)(5) provides for the ROE Collar calculation to be consistent with Section 16-108.5 and Section 16-108.5 specifically requires use of a year-end rate base in multiple contexts. The Commission agrees with Staff and ComEd that the AG's and CCI's proposal to use an average rate base rather than a year-end rate base in calculating the ROE Collar adjustment is inconsistent with and contrary to EIMA. Accordingly, the Commission rejects the proposal to use an



average rate base rather than a year-end rate base in calculating the ROE Collar adjustment.

**C. Do the tariffs filed on May 30, 2013 by ComEd correctly reflect the appropriate tax treatment in calculating interest on the reconciliation balance in the formula rate tariff as authorized by the Public Utilities Act?**

**ComEd's Position**

ComEd maintains that its formula rate and tariffs filed on May 30, 2013, comply with the requirements of the PUA and correctly reflect the appropriate tax treatment for calculating interest on reconciliation balances.

According to ComEd, it would be improper to net deferred income taxes related to the reconciliation balance against the reconciliation balance before interest is calculated, as prior to collecting the reconciliation balance ComEd has received no tax benefit. The cash receipts, as well as the tax payment, are deferred.

ComEd observes that witnesses for the AG and CCI propose an unlawful and improper reduction to the reconciliation balance for purposes of calculating the interest on that balance. Specifically, the AG and CCI propose that the accumulated deferred income tax ("ADIT") related to the reconciliation balance be netted against the reconciliation balance before calculating the interest amount. ComEd argues that this proposal is inconsistent with and violates the existing formula and would result in a reconciliation balance dramatically different from that specified by the formula's calculations. ComEd notes that the Commission rejected that same argument in Docket No. 11-0721, asserts that nothing has changed since that time to warrant a departure from the Commission's prior decision, and further submits that nothing in P.A. 98-0015 would support any change in the disposition of this ADIT argument.

ComEd argues that no party does, or can, dispute the fact that ComEd did not receive any cash from ratepayers in 2012 related to the underlying reconciliation balance. However, according to ComEd, it has incurred carrying costs – that is, the time value of money – related to the full 2012 reconciliation balance. ComEd claims that because the rates in effect did not recover the reconciliation balance or its carrying costs, ComEd should earn an interest rate on its full cost of financing that balance until it is able to collect the revenues related to those costs in 2014. ComEd rephrases its position, stating that taxes related to the reconciliation are deferred because the revenue is deferred, and that deferral provides no tax benefit to ComEd. ComEd asserts that, as a result, this deferred tax liability represents an amount that ComEd must pay in the future, and is an amount that ComEd has not recovered from customers through rates – therefore, ComEd has no offsetting tax benefit with which to fund these carrying costs.

ComEd observes that the AG argues that ComEd receives a real cash benefit from the deferral of income taxes, and that changes in ADIT provide incremental cash

flow to utilities through the change in timing of the payment of cash income taxes associated with such tax deferrals. In response, ComEd argues that it is not sufficient for the AG to conclude that deferred taxes should reduce the revenue requirement simply because, generally, accumulated deferred income taxes are deducted from a utility's rate base. ComEd distinguishes the deferred taxes at issue here from "typical" ADIT, noting that although the Commission does routinely recognize ADIT liability balances as rate base reductions, this only occurs when the ADIT liability results in a cash benefit to the utility in lower taxes paid in the current year. According to ComEd, the lower taxes associated with "typical" ADIT create a tax benefit to the utility, which then results in cash available to fund rate base investments. ComEd argues that, in contrast to the AG's claims, the reconciliation amount is not recovered by the utility until a later year and thus produces no current cash benefit; in simple terms nothing exists against which to "net" the deferred taxes.

Witnesses for the AG and CCI argue that the ADIT liability on the reconciliation is a tax benefit, and that taxes currently payable are lower because of the reconciliation. In contrast, ComEd asserts that the ADIT liability does not represent a current cash tax benefit. Instead, it represents a future tax liability. Moreover, according to ComEd, taxes that are currently payable are not impacted by the reconciliation – they are simply lower than they would have been had ComEd received more revenue and been paid the reconciliation balance earlier.

The AG further argues that changes in ADIT provide incremental cash flow to utilities through the change in timing of the payment of cash income taxes associated with such tax deferrals. According to the AG, even when utilities are in a Net Operating Loss ("NOL") carryforward position, the size of the NOL in each tax year is directly impacted by changes in the reconciliation balance regulatory asset, and the resulting NOL deferred tax asset is included in rate base to directly impact utility rates. ComEd submits that this argument wrongly interprets the effect of the NOL and should be rejected. According to ComEd, the NOL carryforward was generated primarily by the 50% bonus depreciation deduction allowed under the Tax Relief Act of 2012. Among other things, the Tax Relief Act allowed companies to accelerate depreciation expense treatment on the tax return, which led to lower taxes for those companies in the near term. ComEd asserts that the purpose of the Act was to create an opportunity for companies to use their tax savings to stimulate the economy. ComEd notes that the AG correctly states that ComEd is currently in a NOL carryforward position, but emphasizes that the AG misinterprets the effect of this tax benefit. In briefing, ComEd describes the effect of the NOL carryforward position:

Without 50% bonus depreciation in 2012, ComEd would have reflected taxable income. Because it will reduce taxes in a future period, by applying this net operating loss to future taxable income, the NOL carryforward is a deferred tax asset. Under the GAAP Accounting Standards Codification ("ASC"), specifically ASC 740, ComEd has reflected a deferred tax asset of \$25 million (jurisdictional portion) for the NOL on WP 4, line 20 of ComEd's 2013 formula rate template (Docket 13-

0318, ComEd Ex. 14.02). The bonus depreciation itself, however, creates a deferred tax liability because there is a temporary difference related to accelerated depreciation, under the bonus depreciation rules, and is included on ComEd Ex. 14.02, WP 4, line 51. For book purposes, ComEd is recording depreciation expense at a slower rate than for tax purposes, thus ComEd is receiving a benefit on its tax return now before reflecting the full expense on its books. The NOL deferred tax asset nets against the bonus depreciation deferred tax liability. Once the NOL is utilized this deferred tax asset is eliminated.

ComEd Init. Br. at 19-20; ComEd Ex. 3.0 at 14. As a result, ComEd argues that its NOL carryforward in the current year is not directly impacted by changes in the reconciliation balance regulatory asset. Further, in ComEd's response to an AG data request in Docket No. 13-0318, ComEd expressly stated that the "deferred tax asset related to the Federal NOL does not affect the deferred income tax position related to the regulatory asset for the under-recovery of reconciliation amounts." ICC Docket No. 13-0318, AG 4.03(d).

ComEd notes that the AG argues that "[t]he reconciliation reveals an under-recovery during the 2012 calendar year because ComEd collected fewer revenues than the revenue requirement authorized by the Commission's Order in Docket No. 12-0321." AG Init. Br. at 31. ComEd asserts that this is incorrect. According to ComEd, while the reconciliation for the 2012 Rate Year does reveal an under-recovery of the revenue requirement to be reflected in rates, it occurs because the Reconciliation Revenue Requirement based on actual costs for the 2012 Rate Year (submitted in Docket 13-0318) was higher than the Initial Revenue Requirement authorized by the Commission for the 2012 Rate Year, not because ComEd collected less than the Initial Revenue Requirement authorized by the Commission for the 2012 Rate Year. ComEd argues that during 2012, contrary to the AG's assertion in its brief, ComEd has not been allowed to reflect in rates the additional costs resulting in the higher Reconciliation Revenue Requirement. As a result, those costs (and their resulting revenues) will not be reflected in rates until 2014 – at which time ComEd will also pay income taxes associated with those additional revenues. In light of the foregoing, ComEd asserts that this relationship (that both the revenues and related taxes will occur in the future) is why ComEd receives no current tax benefit from the deferral of taxes on the reconciliation balance.

ComEd argues that the AG's argument that its proposal is consistent with the language of Section 16-108.5(d)(1) misreads and misapplies the statutory language. According to ComEd, EIMA provides that interest is to be paid on the reconciliation balance, not on the reconciliation balance less deferred taxes: "Any ... under-collection indicated by such reconciliation ["of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year"] shall be ... recovered as an additional charge to, ... with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate

year.” 220 ILCS 5/16-108.5(d)(1); ComEd Reply Br. at 15. ComEd further argues that where EIMA intended that adjustments be made, to an amount or a balance, it has done so specifically, as in the case of projected plant additions which are to be included on a net basis considering updated depreciation reserve and expense. 220 ILCS 5/16-108.5(c)(6). ComEd submits that its method of calculating the allowed interest on the entire reconciliation balance - instead of the AG’s (fictional) net of tax reconciliation amount - permits ComEd to earn the allowed interest on only the lost net cash flow.

ComEd further notes that the same relationship exists where the reconciliation results in an over-recovery. If less than the full reconciliation balance accrued interest, then customers – in cases where the utility over-collected prior to reconciliation – would receive interest on only about 60% of the money they would have “advanced” to the utility. According to ComEd, that approach would not fully credit to customers the interest on funds that they have provided, just as the intervenors ADIT argument would deprive ComEd of recovering interest on a major portion of its deferred revenues.

ComEd asserts that CCI’s example and related discussion, as presented in its Initial Brief, reinforces the correctness of ComEd’s approach. CCI’s example assumes a reconciliation balance of \$100,000 and an effective tax rate of 41%. CCI posits that the inability to recover that \$100,000 in the current year (2012 in the example) results in a net-of-tax investment of \$59,000. ComEd submits that all parties agree that ComEd “should only be allowed to recover carrying costs on its out-of-pocket net cash investment of \$59,000” as this will make ComEd “whole” for the delayed recovery of the \$100,000 reconciliation balance. ComEd Reply Br. at 16. However, ComEd argues that it will not be made whole unless the carrying charges are applied to the full reconciliation balance as opposed to only the “net of cash” investment. Assuming a 10% interest rate and a one-year delay of recovery, ComEd submits that the amount the utility company will need to recover to be made whole is \$64,900, which is the net cash investment plus interest thereon at 10% ( $\$59,000 \times 110\% = \$64,900$ ). According to ComEd, the only way this will happen is if the interest rate is applied to the full \$100,000 reconciliation balance, as shown below:

Undercollection =	\$100,000
Plus interest on undercollection	\$ 10,000
Less taxes at 41%	\$ 45,100
Net of tax recovery =	\$ 64,900

ComEd argues that recovery of anything less than the \$64,900 in the example will prevent the utility from being made whole. However, according to ComEd, that is precisely the result of the AG and CCI proposal. If, in calculating the net cash to the utility in the example, interest is applied only to the net cash investment instead of the full reconciliation balance, the utility will recover less than the \$64,900 needed to make it whole, as shown below:

Undercollection =	\$100,000
Plus interest on \$59,000	\$ 5,900
Less taxes at 41%	\$ 43,419
Net of tax recovery =	\$ 62,481

Accordingly, ComEd argues that it ought to be allowed to recover interest, at the allowable rate (WACC), on the full reconciliation balance, not on only the balance net of deferred income taxes. ComEd further submits that the proposals of the AG and CCI are inconsistent with EIMA and the approved rate formula, and should be rejected.

### **Staff's Position**

Staff's position is that the tariffs filed on May 30, 2013 by ComEd reference revised schedules that would correctly present ComEd's reconciliation balance that would be subject to a calculation for interest as authorized by Section 16-108.5(d)(1) of the Act. Staff does not support the proposal made by Mr. Brosch, Mr. Effron, and Mr. Gorman to net ADIT related to the reconciliation balance before calculating interest. According to Staff, the proposal, regardless of its merits, should be rejected because the Act, in particular Section 16-108.5(d)(1), does not state that the reconciliation amount is to be reduced by ADIT. Section 16-108.5(d)(1) provides in part that:

Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d)(1).

Staff states that when interpreting a statute, the primary objective is to ascertain and give effect to the intent of the legislature. *Metro Utility Co. v. Illinois Commerce Commission*, 262 Ill.App.3d 266, 274 (1994). The best indication of what the legislature intended is the statutory language itself. *Id.* Clear and unambiguous terms are to be given their plain and ordinary meaning (*West Suburban Bank v. Attorneys Title Insurance Fund, Inc.*, 326 Ill.App.3d 502, 507 (2001)) and where statutory provisions are clear and unambiguous, the plain language as written must be given effect, without reading into it exceptions, limitations, or conditions the legislature did not express. *Davis v. Toshiba Machine Co.*, 186 Ill.2d 181, 184-185 (1999). The Act requires that any reconciliation over or under collection be refunded or recovered with interest. 220 ILCS 5/16-108.5(d)(1). Staff submits that the phrase "[a]ny over-collection or under-collection" refers to the whole reconciliation balance and not some derivative thereof.

Staff reasons there is no language in Section 16-108.5(d)(1) providing for ADIT to reduce the reconciliation balance.

### **AG's Position**

The AG note that EIMA provides for an annual reconciliation process that allows the electric utility to reconcile the revenue requirement set for the prior year with actual costs incurred in that year, and to either apply a surcharge or a credit to consumers' bills to provide the utility with "what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the time of filing." 220 ILCS 5/16-108.5(c)(6). In addition, the reconciliation provisions of EIMA provide for the utility to collect interest on the reconciled revenue requirement as follows:

Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior year, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d)(1).

Both AG witnesses Brosch and Effron, and CCI witness Michael Gorman took issue with the Company's calculations of interest upon the reconciliation under-recovery in the formula rate docket and they carry these identical concerns to the Commission's investigation in this docket. It is undisputed that ADIT associated with the reconciliation process exists. The AG maintain that the Company's position is that these ADIT balances should be ignored in applying interest and also ignored in determining rate base, a position that conflicts with fundamental ratemaking practices and fairness toward ratepayers.

1. The deferral in the payment of income taxes is a real cash benefit and should be recognized in the calculation of interest on the reconciliation balances.

According to the AG's witnesses, the reconciliation reveals an under-recovery during the 2012 calendar year because ComEd collected fewer revenues than the revenue requirement authorized by the Commission's Order in Docket No. 12-0321. Consequently, the Company paid less in income taxes in 2012 than it would have paid had the higher revenue requirement been collected in cash, which is income taxable. As a result, the reconciliation balance must be reduced by the temporary income tax savings associated with the lower revenue level to determine ComEd's net cash investment in the reconciliation balance. ComEd pays income taxes only on its cash revenues when they are collected by the utility. The AG submits that if the recovery of

reconciliation surcharge revenue is delayed, then it follows that the payment of related income taxes is also delayed. ComEd witness Brinkman concurred.

The AG add that ComEd's 2012 revenue requirement was under-recovered and reconciliation revenues are to be later collected from ratepayers, causing the Company to record an incremental deferred income tax liability associated with the amounts owed by and recoverable from ratepayers. These deferred income tax liabilities reduce the incremental capital ComEd actually has invested in the reconciliation under-recovery, because the reconciliation revenues that were recorded but not recovered in providing service are not currently recognized as taxable for income tax purposes. Given the lower after-tax investment required from investors because of these income deferral benefits, the amount of interest properly applied to the reconciliation under-recovery should be reduced by the avoided cash income tax payments. Interest should only apply to the net-of-tax reconciliation balance to reflect the incremental capital investment driven by the over or under-recovery of revenues. The AG state that this ensures, in this case, that rates are not excessive, or, when reconciliations produce credit balances, insufficient.

The AG assert that deferrals of this type of income tax expense have the effect of reducing the amount of capital investment ComEd must make in support of the reconciliation revenue requirement that has not yet been recovered. Full and complete accounting for income tax expenses recognizes that income taxes often impact expenses payable in more than one accounting period. The delayed collection of reconciliation revenues under formula ratemaking creates a "taxable temporary difference" under these rules. This occurs because the utility pays taxes on revenues actually received in the reconciliation year rather than on the revenue level indicated in the reconciliation balance. The AG explain that reconciliation revenues are recorded as per book revenues in the reconciliation year (either as excess or deficiency revenues) while such revenues will not become income taxable until the year they are approved by the Commission and charged or credited to ratepayers.

The AG notes that the record evidence confirms that there are deferred income tax effects directly attributable to the reconciliation balance. ComEd did not actually pay income taxes in 2012 for revenues it did not collect in 2012 but will collect in 2014. Therefore, ComEd has no interest expense related to those (not-yet-paid) taxes. Application of interest to only the net of income tax reconciliation under- or over-recovery is consistent with the economic reality that the utility does not pay income tax due to the delay in the recovery of taxable revenues and reduces the overall interest burden upon ratepayers by about 40 percent. Netting ADIT from the reconciliation over- or under-recovery likewise can benefit the utility. The AG state, for example, when a reconciliation over-recovery occurs, offsetting applicable deferred income taxes against the reconciliation amount on which interest is accrued is of benefit to the utility, because the utility is then required to credit customers for interest on only the net source of funds provided by the over-recovery.

The AG continue that the Company is able to deduct all allowable costs incurred to provide service to customers in the reconciliation year on its reconciliation year income tax returns, which reduces the taxable income for that year. However, a portion of the accrued revenues recorded by ComEd, to reflect its entitlement to later recovery of reconciliation revenues, are not currently taxable. The impact of this imbalance between higher deductible costs relative to somewhat lower taxable revenues because the reconciliation revenues are not currently taxable, causes ComEd to have the use of non-investor supplied funds in the form of income tax deferrals.

The AG find that ComEd is allowed under formula ratemaking to earn interest while waiting to collect the accrued reconciliation revenues, while at the same time deferring the payment of income tax expenses on such recoveries. This tax deferral benefit effectively reduces the Company's after tax cash flows by about 41 percent of the accrued reconciliation revenues.

2. Reducing the Reconciliation Over- or Under-Recovery for ADIT is consistent with language of Section 16-108.5(d)(1) and the Public Utilities Act as a whole

Section 16-108.5(d)(1) provides that “[a]ny over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.” 220 ILCS 5/16-108.5(d)(1). The AG contend that this statutory provision does not say, as ComEd’s and Staff’s interpretation suggest, that the interest should be applied to only the full, gross amount of the “reconciliation balance.” According to the AG, the reference to the “over-collection or under-collection” clearly references the cash flow amount associated with ComEd’s 2012 revenue collection. This is not a rote, gross subtraction calculation that does not reflect ComEd’s actual costs avoided (including income tax payments avoided) incurred during the 12-month period being reconciled.

The AG note that a fundamental principle of statutory construction is to view all provisions of a statutory enactment as a whole, with each provision construed in connection with every other section. *Roselle Police Pension Bd. v. Village of Roselle*, 232 Ill.2d 546, 552 (2009). This concept of allowing interest only on the actual, net-of-tax under- or over-collection is consistent with the entire EIMA statute. See, e.g., Section 16-108.5(c) (“A participating utility may elect to recover its delivery services costs through a performance-based formula rate approved by the Commission, which shall specify the cost components that form the basis of the rate charged to customers with sufficient specificity to operate in a standardized manner and be updated annually with transparent information that reflects the utility’s actual costs to be recovered during the applicable rate year, ...”); and Section 16-108.5(c)(6) (“The performance-based formula rate approved by the Commission shall... [p]rovide for an annual reconciliation, as described in subsection (d) of this Section, with interest, of the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the



utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date.”)

The AG submit that while the statute could have directed the Commission to apply interest to the full reconciliation “balance” – the term ComEd insists on using throughout its testimony and arguments -- it did not. This provision only authorizes interest on the “over-collection or under-collection” indicated by such reconciliation. 220 ILCS 5/16-108.5(d)(1). This requires the Commission to determine the actual over- or under-collection, taking into consideration the cash flow effect of the formula rate process. The Commission should apply interest to the utility’s actual cash costs in 2012 to conform to the legislative intent that the reconciliation reflects “the actual cost information for the applicable calendar year.” 220 ILCS 5/16-108.5(d)(1). The utility pays income taxes on the revenues it receives, and the amount of taxes actually paid by the utility in a given calendar year depends on the revenues actually received. Thus, the AG continue, regardless of whether the reconciliation revenue requirement is larger or smaller than that in effect during the year, the determination of the actual cash over- or under-collection indicated by the reconciliation will be affected by the timing of the payment of the income taxes.

Moreover, the absence of a specific reference to taxes in connection with the over-collection or under-collection indicated by such reconciliation does not mean that the effect of reconciliation ADIT amounts should be ignored. The AG state that the effect of deferred income taxes is plainly incorporated into the revenue requirement. ADIT is routinely considered as part of rate base in the Company’s formula rate updates; the Appendices to the Commission’s Orders in Docket Nos. 12-0001 and 12-0293 contain extensive treatment of the Company’s ADIT.

The AG mention that in reviewing ComEd’s first formula rate filing, the Commission commented on the need to apply basic accounting principles in implementing the formula rate and to consider the effect of ADITs even in the absence of a specific direction in the statute and concluded that “If the Commission were to ignore ADIT on ComEd’s plant investments, we would be ignoring basic accounting principles and appellate precedent” and further opined that “...One would expect that, after the General Assembly treated so many issues with specificity that it would have specifically excluded ADIT in the statute, if that were its intent. It did not.” Docket 11-0721, Order at 59-60 (May 29, 2012).

The effect of deferred income taxes is considered by all parties on many issues despite the absence of specific direction to consider ADIT or taxes. The AG submit that this is because, as the Commission concluded in Docket 11-0721, basic accounting principles as well as Illinois case law recognize that ADIT should be treated as a source of non-investor funds, and the General Assembly did not direct the Commission to ignore this fundamental regulatory and accounting principle.

### **CCI's Position**

CCI aver that ComEd has incorrectly calculated the reconciliation balance on which its interest calculation should be based, causing the calculation of the interest on that balance to be inflated by over 40%. Although the reconciliation balance is positive (meaning ComEd's initial rates recovered less than its 2012 actual revenue requirement), CCI state that ComEd did not actually have to finance that entire difference, and that (because of the tax effects of the under-recovery) the deficiency ComEd actually carried was not equal to the entire reconciliation balance ComEd calculates. Because ComEd's costs were higher than the level reflected in rates, ComEd was permitted to take higher tax deductions and pay lower income taxes than if the reconciliation balance were zero or negative. CCI note that ComEd's actual net cash investment is the difference between the projected and actual revenue requirement, less the reduction in income taxes. CCI argue that ComEd's proposed balance for the interest calculation should be reduced by \$59 million.

CCI witness Mr. Gorman provided an illustrative calculation to demonstrate how ComEd's net cash investment could be less than the total difference between the awarded and actual revenue requirements. If ComEd incurred \$100,000 more in payroll expense during 2012 than was reflected in the revenue requirement awarded for 2012, the Company would have a \$100,000 higher reconciliation balance. However, ComEd would deduct the entirety of the higher payroll expense from its income for purposes of its 2012 income taxes. As a result, assuming a 41% tax rate, ComEd would realize \$41,000 of reduced income taxes associated with the higher payroll expense (\$100,000 X 41%). Therefore, ComEd would only have carried a cash reconciliation balance amount of \$59,000 for the additional payroll expense (\$100,000 - \$41,000).

CCI explain that ComEd's actual cost of carrying the unrecovered payroll in this illustration is based on its out-of-pocket net cash investment (cash expenditures less income taxes reduction) of \$59,000 through the period the full accounting balance (\$100,000) is recovered. As such, ComEd should only be allowed to recover carrying costs on its out-of-pocket net cash investment of \$59,000. ComEd would be made whole for the delayed recovery of the \$100,000 reconciliation accounting balance by full recovery of the net investment required, and the carrying charges on that amount (\$59,000) during the recovery period.

CCI contend that the tax savings described mean that ComEd's out-of-pocket cash position is not the total reconciliation balance, but rather the net of tax reconciliation balance. CCI argue that ComEd should not receive interest on any more than its actual net cash investment, which is the difference between the reconciliation accounting balance and the reduction in its income tax liability. CCI state that calculating interest on only the amount of ComEd's net cash investment reduces the Company's reconciliation interest by \$12.6 million.

CCI aver that ComEd is incorrect in denying that it receives any tax or cash benefit prior to collecting the reconciliation balance from ratepayers. CCI state that

ComEd's accounting for these tax effects confirms the reality of the reduced need for financing. CCI submit that, in accordance with Generally Accepted Accounting Principles ("GAAP"), the Company recorded an increase in revenue in 2012 as a result of the expected future recovery of the reconciliation balance. Further, the Company recorded a deferred income tax expense associated with the revenue recognition. ComEd's delayed tax payment is reflected on ComEd's books in the form of an accumulated deferred income tax ("ADIT") balance, note CCI. This allowed ComEd to realize increased earnings in 2012. CCI reasons that the net impact is that the Company recorded higher earnings (due to the reconciliation revenue), but delayed payment of income tax associated with the reconciliation revenue until it is actually recovered from ratepayers in 2014.

Because ComEd does not incur the actual tax payment associated with the reconciliation revenue until it is actually recovered, the out-of-pocket cost to ComEd is the after-tax reconciliation revenue requirement. CCI state that ComEd delays the income tax payments on the revenue requirement until it is actually recovered from ratepayers. The Company received a cash benefit as a result of the increased tax deductions (and thus lower taxes paid) as a result of incurring greater expenses in 2012 than were anticipated. Thus, say CCI, there were both tax and cash benefits to ComEd resulting from the positive reconciliation balance.

While ComEd frames its argument differently, focusing only on ADIT, CCI suggest that only the terms (not the tax effect) are different. ComEd alleges that if it recovers only its net-of-ADIT investment in the reconciliation balance, it will not fully recover its investment. In her direct testimony, Ms. Brinkman provides two examples attempting to show ComEd's deficit. CCI contend that the fatal flaw of both examples is that they do not acknowledge the tax deductibility of the interest expense recovered from ratepayers. That is, Ms. Brinkman incorrectly assumes that the carrying charge does not have an offsetting deduction for interest expense. CCI witness Mr. Gorman corrected Ms. Brinkman's examples to reflect that tax effect. In both examples, once the deductible interest expense is reflected, ComEd is actually left with the same after-tax revenue requirement. CCI add that though she had an opportunity in surrebuttal testimony, Ms. Brinkman did not rebut Mr. Gorman's corrections to her example or the resulting conclusion.

CCI explain that Mr. Gorman examined the issue from a perspective similar to ComEd's, to refute ComEd's claim that the utility receives no tax or cash benefit prior to collecting the reconciliation balance from ratepayers. Mr. Gorman noted that the Company in fact benefitted from recording deferred income tax expense because it was able to defer the payment of income taxes while it awaits recovery of reconciliation balances. That is because the reconciliation revenues recorded, but not yet recovered, are not currently recognized for income tax purposes. That deferral reduces the amount of capital investment the Company must make to support the reconciliation revenue requirement - which has not yet been recovered. The AG's expert Mr. Brosch recommends, like Mr. Gorman, that the interest on the reconciliation balance should be recorded only on ComEd's net-of-tax incremental capital investment.

CCI note that AG witness Mr. Brosch had raised concerns about the issue of the reconciliation balance that is allowed to earn interest in ICC Docket 11-0721. At that time, the Commission did not make a definitive ruling, citing concerns about the completeness of the record. ICC Docket No. 11-0721, Final Order (May 29, 2012) at 167. Mr. Brosch also raised the issue in ICC Docket Nos. 12-0001 and 12-0293, Ameren's initial formula rate setting docket and its first reconciliation, but the net-of-tax concern was not addressed in the Commission's analysis and conclusions in those orders. CCI argue that in this case, Mr. Brosch and Mr. Gorman have provided ample evidence to support recovery of interest only on ComEd's actual net cash investment. The Commission would be well within its authority to reconsider the issue based on this record, which contains compelling evidence that only a net-of-tax reconciliation balance is appropriate, say CCI.

CCI point out that AG witness Brosch testified that ComEd's books in 2012 show an ADIT liability of \$34.077 million for federal income taxes and \$10.22 million for state income taxes (a total of \$44.3 million), comprised of expected delayed payment of income taxes due to the delayed recovery of ComEd's under-collection in 2012, demonstrating the magnitude of the impact of the effect of tax savings on the reconciliation balance (again presented using an ADIT perspective and terminology). CCI submit that those ADIT balances are recorded in compliance with GAAP, under which full and complete accounting for income taxes must recognize that filing tax returns and paying income taxes will impact expenses payable in more than one accounting period. CCI state that the delayed collection of reconciliation revenues in 2012 created a "taxable temporary difference" under Accounting Standards Codification 740-10-30-5.

CCI maintain that the income tax deferrals ComEd admits it recorded as a result of under-recovering its costs in 2012 will not be reflected elsewhere if the Commission does not accept Mr. Gorman's adjustment. Even though the identified ADIT tax deferrals arise entirely from the delivery service formula ratemaking process, CCI aver ComEd has allocated them as "Non DST" and includes none of the \$44.3 million ADIT balance in rate base. In doing so, ComEd ensures that all of the income tax deferral benefit is kept for the sole benefit of its shareholders.

CCI point to ComEd's argument that "The formula template defines how the reconciliation interest is calculated and how tax effects are determined and calculated. It does not provide for 'netting' accumulated deferred income taxes with the reconciliation adjustment within this calculation." ComEd Ex. 1.0 Corr. at 22:440-443. CCI argue that it is telling that ComEd must rely on what it calls the formula – actually calculation sheets that underlie amounts that are the subject of this investigation – rather than what the statute requires. CCI note ComEd's statement that the CCI and AG proposal to allow ComEd to recover interest on only its actual cash investment in the reconciliation balance (i.e. the net-of-tax balance) "is inconsistent with and violates the existing formula and would result in a reconciliation balance dramatically different from that specified by the formula's calculations." ComEd Init. Br. at 17. CCI argue that

ComEd is relying on its own unauthorized modifications to “the formula” made in Docket No. 13-0386 – changes that are explicitly under investigation in this docket – rather than what is required by the Act. CCI state that the language of the Formula Rate Law does not prescribe how the reconciliation balance (on which interest is calculated) should be determined. That determination must be made by the Commission, on the basis of the provisions of the PUA, including the Formula Rate Law. CCI submit that the fact that the Commission has undertaken that specific task in this proceeding contradicts ComEd’s assumption or argument that the issue is settled.

CCI continue that the Formula Rate Law does not even use the term “reconciliation balance”, much less does it read: “The utility shall recover its gross reconciliation balance, plus interest.” If that is what the legislature intended, it could have said that. Instead, the legislature did not address whether the reconciliation balance should be gross or net-of-tax. CCI claim that it is up to the Commission, then, to determine -- based on the over-arching “actual cost” recovery objective of formula rates -- the specific calculations of over- and under-collections and related interest amounts, within the framework of the Act.

CCI assert that the legislature has demonstrated that it can use very specific language when it intends to displace the Commission’s ratemaking determinations. For example, with respect to the interest rate to be calculated on the reconciliation balance, the Act requires: “...interest calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior year...” 220 ILCS 5/16-108.5(d)(1). Another example CCI point out is the requirement that the Company shall earn an “investment return at a rate equal to the utility’s weighted average cost of long-term debt, on the pension assets...” 220 ILCS 5/16-108.5(c)(4)(D). CCI state that such specificity does not exist on this issue. The fact that the term “reconciliation balance” does not even appear in the statute, much less with specific directions to calculate interest on a “gross” balance, requires that the Commission determine the appropriate methodology for that calculation.

CCI find that Staff’s only articulated grounds for rejecting the proposal of Mr. Gorman and Mr. Brosch are its flawed interpretation of the statute. In addition, CCI argue that Staff’s position in this case stands in contrast to its position in the Rehearing of ComEd’s initial formula rate setting docket, ICC Docket No. 11-0721. In that case, Staff’s position was that the interest rate should be calculated on a net of tax basis. ICC Docket No. 11-0721, Final Order on Reh’g (Oct. 3, 2012) at 28. CCI conclude that Staff’s position, taken on the merits of the adjustment, was correct in that case and that Staff’s legal interpretation of the statute in the instant case is not.

CCI thus recommend that the Commission accept the proposals of Mr. Gorman and Mr. Brosch to calculate interest only on ComEd’s net-of-tax reconciliation balance.

### **Commission Analysis and Conclusions**

The Commission finds that both ComEd and Staff have correctly interpreted the statute on this issue. We find that there is no language in Section 16-108.5(d)(1) of EIMA providing for ADIT to reduce the reconciliation balance. Clear and unambiguous terms are to be given their plain and ordinary meaning (*West Suburban Bank v. Attorneys Title Insurance Fund, Inc.*, 326 Ill.App.3d 502, 507 (2001)) and where statutory provisions are clear and unambiguous, the plain language as written must be given effect, without reading into it exceptions, limitations, or conditions the legislature did not express. *Davis v. Toshiba Machine Co.*, 186 Ill.2d 181, 184-185 (1999). The Act requires that any reconciliation over or under collection be refunded or recovered with interest. 220 ILCS 5/16-108.5(d)(1).

### **III. IMPLEMENTATION OF RATE FORMULA CHANGES, IF ANY**

ComEd maintains that there is no basis for the Commission to make any change in ComEd's approved rate formula. However, in the event that there were to be any changes made, all parties agree with ComEd's proposal that those changes should be given effect both prospectively and retrospectively back through the decision in Docket No. 11-0721, in the form of a single rolled-up credit or charge (as the case may be) applicable in 2014. CCI did not opine on this topic.

We agree with the positions expressed and supported by ComEd, Staff, and intervenors in this docket. In the event that any changes are to be made to ComEd's rate formula, those changes will be given effect both prospectively and retrospectively back through the decision in Docket No. 11-0721, in the form of a single rolled-up credit or charge (as the case may be) applicable in 2014.

### **IV. FINDINGS AND ORDERING PARAGRAPHS**

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Commonwealth Edison Company is an Illinois corporation engaged in the transmission, distribution, and sale of electricity to the public in Illinois and is a public utility as defined in Section 3-105 of the Public Utilities Act;
- (2) the Commission has jurisdiction over the parties and the subject matter herein;
- (3) the recitals of fact and conclusions of law reached in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact and conclusions of law;
- (4) the proposed revision to Commonwealth Edison Company's filed formula rate regarding the calculation of interest on its reconciliation balance

approved herein is consistent with Public Acts 97-0616, 97-0646, and 98-0015;

- (5) the revisions to Commonwealth Edison Company's rate formula authorized by this Order will be given effect both prospectively and retrospectively back through the decision in Docket No. 11-0721, in the form of a single rolled-up credit or charge applicable in 2014;
- (6) Commonwealth Edison Company should be authorized to place into effect a revised formula rate and tariffs consistent with the findings of this Order;
- (7) the revisions authorized by this Order shall take effect beginning on the first billing day of the January 2014 billing period following the date of the final order in this docket; the revised tariff sheets, however, shall be filed no later than December 5, 2013, with the tariff sheets to be corrected thereafter if necessary; and
- (8) all motions, petitions, objections, and other matters in this proceeding which remain unresolved should be disposed of consistent with the conclusions herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets at issue and presently in effect for electric delivery service rendered by Commonwealth Edison Company are hereby permanently canceled and annulled effective at such time as the revised electric delivery service tariff sheets approved herein become effective by virtue of this Order.

IT IS FURTHER ORDERED that Commonwealth Edison Company is authorized to file revised tariff sheets with supporting workpapers in accordance with Findings (6) and (7) of this Order, applicable to electric delivery service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that Commonwealth Edison Company shall update its formula rate in Docket 13-0386 in accordance with this Order.

IT IS FURTHER ORDERED that all motions, petitions, objections, and other matters in this proceeding which remain unresolved should be disposed of consistent with the conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

DATED:  
BRIEF ON EXCEPTIONS DUE:

November 13, 2013  
November 18, 2013.

Glennon Dolan  
D. Ethan Kimbrel  
Administrative Law Judges